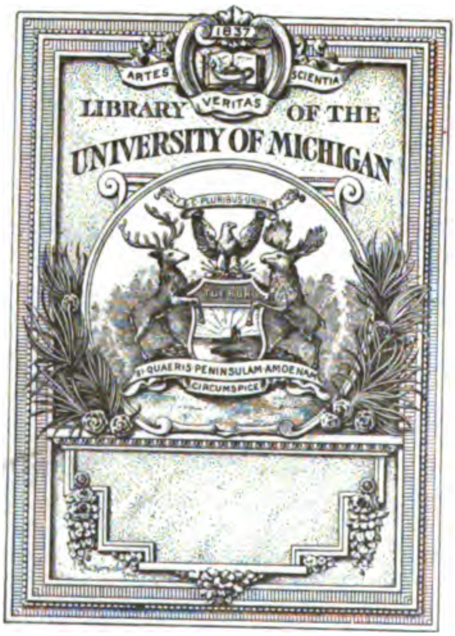
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A RATIONAL BANKING SYSTEM

A COMPREHENSIVE STUDY OF THE ADVANTAGES OF THE BRANCH BANK SYSTEM

BY

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INTRODUCTION

Effects of Recent Panics

ON two occasions in the past twenty years the problem popularly known as the banking question has been forcefully pressed upon the attention of the American people. After the panic of 1893, and again after the panic of 1907, public-spirited men in the different parts of the United States gave themselves earnestly to the task of devising methods by which bank creditors might be made more secure and banking panics prevented. The people, in very considerable numbers, were hit by the financial disorders of those two years. Some were depositors who suffered through the stoppage of the banks in which their funds were placed; some were inconvenienced and injured through the general suspension of cash payments; some were borrowers and experienced heavy loss through the action of panic-stricken bankers in exacting payment of all advances as they came due; some were crippled and others ruined by the great depreciation in securities that occurred on both occasions. Besides those who suffered material loss there were many in whose eyes the frequent breakdown of the banking system constituted a national humiliation. Under these circumstances it was but natural that the discussion of reforms should centre

chiefly around the problems of how to make depositors more secure and less liable to panic, and how to introduce into the banking system some new elements calculated to enable the banks to stand up and pay cash, as do the banks in other great countries, through crises and emergencies.

The Banking System's Acknowledged Defects

Then in certain years between the panics the inelasticity of the currency has inflicted considerable loss upon the commercial and financial interests of the country, through the stringency and trouble which it caused during the fall or crop-moving season. So there has also been much discussion as to how the currency should be improved or changed.

These comprise the defects of the banking system of the United States which are recognized on all sides. It is, however, commonly believed that the defects may be removed or covered without making radical alterations in the character of the banks. Nearly all of the suggested reforms proceed upon the assumption that the system of local single-office banks is well adapted to the needs of the country and that it should be tenaciously adhered to. In the banks and outside of them exists a strong sentiment in favor of the present system and against branch banks.

Why Branch Banks Are Not Considered

Thus Senator Aldrich in his address at Chicago on the banking question, in November, 1909, mentioned the branch idea as something to be eliminated from the discussion of practicable remedies. His words, as quoted in the *New York Journal of Commerce*, are: "Whatever may be the advantages of a system of branch banking in other countries, I do not think it is possible to adapt it to existing conditions in the United States. The twenty-five

thousand banks now in existence are largely independent institutions whose managers are familiar with the wants and requirements of the communities in which they are located. The great mass of the people who use banking facilities, either as depositors or borrowers, would be unwilling to give up the advantage of that intimate personal knowledge of the local bank officers and managers which they believe to be essential to their interests. It would be difficult, for instance, to convince borrowers and depositors in a small town in Illinois that a man who had always lived in the same community would not have a clearer and more sympathetic appreciation of their needs and credit than an agent sent from one of the large banks in New York whose principal ambition might be to earn the largest possible amount of money for his institution rather than to develop the prosperity of the community to which he was assigned. I realize, of course, that in the United States, as in Germany, there is a tendency on the part of the large banks in the reserve and central reserve cities to establish a rather close community of interest with correspondents whose business and organization is more or less affiliated with the central institution. This arrangement has many of the advantages of branch banks without being subject to the positive objections which exist with reference to the latter plan."

While this sentiment, to which Senator Aldrich refers, retains its present force it is obviously impossible that there should be any general movement toward the institution of branch banking. Even if the legislatures were to authorize branch banks they would not make substantial headway while neither the bankers nor the people wanted them.

The Case for Branch Banks

Briefly stated, the object of this book is to gain friendship for the branch-bank idea. With regard to the attitude of the banking interests it is possible to see some

progress toward a favorable opinion. I can remember how that some fifteen years ago scarcely a voice among the bankers was heard in favor of the branch system as a solution of the monetary troubles of the United States. Now there is a considerable number of bankers in the large cities who favor the idea and who would actively institute branches throughout the country if they were permitted to do so. But the so-called country bankers are bitterly opposed. I am convinced that if they had a more accurate notion as to how they, their stockholders, their employees, their customers, and their country would benefit from the conversion of their single offices into branch banks this hostility would tend to disappear. If it were materially softened, and if in time the sentiment of the general public were to become more favorable, the way would be opened for a satisfactory settlement of the difficult financial problems now before the nation. I propose, therefore, to present a comprehensive statement of the case for branch banks, in the course of which I shall try to show the advantages that would accrue to various classes of the people and to the country as a whole upon their adoption. Also I shall try to answer the various objections commonly urged in the United States against the branch system. I think that many of my readers will be surprised at the number of counts which can properly be included in the indictment of the single-office type of banks, and at the variety and number of advantages to be expected to accompany the institution of the right type of branch bank.

The Author's Qualifications

For the enlightenment of those who wish to know my qualifications for undertaking this work I might say that I entered the service of one of the large Canadian branch banks as junior at the age of seventeen, and served nineteen years. My service covered the various posts from

junior up to branch manager, at a country branch in Ontario, at a Western financial centre, and at a Manitoba country town; it was rounded out by a five-year period at the head office in Montreal. In the five years that have elapsed since the completion of my banking service I have lived for the greater part of the time in New York State and have devoted myself mainly to the study of banking and financial matters and to financial writing. My study of United States banking conditions has continued for more than fifteen years.

How the Argument Will Be Presented

I have concluded that in dealing with the subject the first importance should not be given to any of the matters which have been so much debated: the security of depositors, the prevention of panics, and the provision of elastic currency. Each one of these questions is, to be sure, of great importance; but, in my opinion, all of them are subordinate to the main question as to how the banks under the present system fulfil, day by day and week by week, the obligations and duties owed by them to the commerce and industry of the country. If agriculture and the great industries and trades do not get from the banks, regularly every day, the measure of support and encouragement to which they are properly entitled and which is regularly accorded to them in other countries, the circumstance constitutes a more serious indictment of the banking system than to charge it with inflicting frequent and unnecessary losses on bank depositors and of going down in disgrace before every first-class panic.

I have considered that the case against the existing system of local single-office banks can be presented best through giving a series of descriptions illustrating how the various interested parties—bank employees and officers, bank customers, borrowers as well as depositors, other citizens who now have no relations with banks, the

corporations, the Government of the United States, and the country itself—fare under the present system, the benefits they enjoy and the inconveniences they are subjected to; and, along with this, to give a description of what their condition would be under a proper system of branch banks.

Several important banking evils will be pointed out which are seen in no other great country than the United States; and it will be shown that they are in fact natural results of the local system, and that they cannot be removed while that system is retained. Also in dealing with the objections to branch banks I shall venture some suggestions as to how certain evils regarded as being associated with them might be eliminated or guarded against. Finally, the question as to how branch banks might become a practical possibility will be dealt with and I shall suggest how they might develop along lines which would not necessitate a great destruction of banking capital, and which would enable each one of the important sections of the country to preserve its financial independence; how each section might, as a matter of fact, be more securely independent of the dreaded Wall Street money power than it is to-day under the system of small local banks.

I

DEFALCATIONS AND FRAUDS

The Record of Banking Frauds

NEARLY everybody understands that a banking system to be useful must possess the confidence of the people it essays to serve. There cannot be full confidence unless the bankers as a class are reputed capable and honorable gentlemen. If thorough confidence does not prevail there will be, among the possessors of cash, many who cannot bring themselves to trust the banks at all, and many of those who do deposit money in banks will be suspicious and watchful, prone to take alarm and to rush for their deposits on the slightest provocation. One of the things strongly influencing the public in its estimation of the banks and of the bankers is the record of defalcations and frauds by bank employees and officers. It is a striking feature of banking in the United States that frauds by bankers are more numerous than in any other highly civilized country. If the daily newspapers in Great Britain be closely examined from year end to year end it will be found that few cases of dishonesty of this kind appear in them. For weeks at a time the record is clear. It is much the same on the Continent of Europe; cables and mail despatches from Europe have very little to say of happenings of this nature. In Canada also the record is satisfactory. Week after week goes by without a single instance of banking fraud appearing in the papers. When they do appear, in nearly every case it is some teller or minor clerk who has stolen a few hundreds or a

few thousands at some branch office of more or less importance; and the occurrence hardly operates at all to lessen the public respect for the banks, or to bring banking into disrepute. Of course if a quick succession of defalcations happened at various branches of one particular bank, acute observers would suspect that the supervising and inspecting system of that bank was lax, and perhaps it would also be suspected that it was below the general standard in regard to the pay and treatment of its men. But when they are of small importance and occur sporadically the defalcations do not affect the banking reputation. There is never any thought, in the public mind, when some country teller of a leading bank absconds with $3,000 or $5,000, that its depositors or creditors are in anywise concerned. Even the shareholders of the defrauded institution take no notice of the loss, as it has no bearing, of any consequence, upon their dividends.

Unenviable Prominence of the United States

But in the United States every week has its crop of bank scandals. There may be two or there may be half-a-dozen. Sometimes the newspapers for days at a time record a fresh fraud each day. One time it is a savings-bank in New England, again a national bank in the Eastern States, then a state bank in the Northwest, then three or four in the West or the South, then back again to the East, every section of the country taking its turn. In a number of cases the loss is heavy enough to cause the closing of the defrauded bank. Often enough the depositors are threatened with loss; always they undergo some anxiety about the safety of their funds; and invariably the stockholders are deeply concerned.

The constant recurrence of these humiliating episodes, and the faithful blazoning of each case all over the country by the press, must have a profound effect in lessening the general estimation of banks in the public mind. A fairly

large number of people must have the idea that about half of the bankers are rogues, and that it is not safe to trust money with any of them. One need not be an expert to see that the prevalence of such an idea must keep many millions of deposits out of the banks, and thus reduce the power of the bankers to care for the industrial and mercantile borrowers.

System of Isolated Small Banks Responsible

Perhaps some persons will argue that there are more frauds in the United States than in Canada because the Republic is so much more populous than the Dominion, and because its business is so much more important. But the difference in population and in the magnitude of business transacted does not satisfactorily account for the phenomenon. If the United States be compared with Great Britain or one of the other leading European countries the disparity in regard to population and business is not quite so great; yet the disparity in the record of banking frauds is plainly to be read. Refuge can hardly be taken in an explanation that the people of the United States are more dishonest than Canadians, Englishmen, or Europeans. Though the citizens of the great American Republic are sometimes said to be more speculatively inclined, more disposed to take large chances, than are Englishmen or Canadians, the statement is open to question; and it is reasonable enough to conclude that the classes in the United States from which the bankers are drawn are fully equal in point of morality to the classes that supply the material for the banking staffs in the other Anglo-Saxon countries. Every day there are forthcoming evidences that Americans, as a people, hate fraud and dishonesty as earnestly as, and perhaps more earnestly than, do the people of other countries. They are vigorously striving all the time to hunt the ugly things down and to destroy them.

It is not at all necessary to defame the character of the people or to search far afield for the explanation of the lower tone of banking in the Republic and of the relatively large number of frauds. It can easily be shown that the system of isolated small banks lends itself peculiarly to the bringing about of just such a state of affairs. In fact it could hardly be otherwise than that the worst showing in this regard should be made by the United States; and, so long as the present banking system endures, in spite of all that can be done by Federal officials, state officials, and banking associations, the frauds and defalcations must necessarily be numerous. Why it is so will now be explained.

The One-Man Control

An examination of the individual cases of banking fraud shows that in a great many of them it is the president or the cashier that is guilty of stealing. There are over twenty-two thousand banks of all kinds in the whole country. In other words, there are over twenty-two thousand individuals in control of the active day-to-day operations of the banking institutions. The active command of a bank may rest with the president, with the vice-president, or with the cashier; one or other of the three conducts the operations in the cases of all of these independent banks. This ruling officer is the law unto the other officers and clerks. Though he is responsible to the board of directors, no board of directors could follow him from transaction to transaction throughout the day, and from day to day throughout the year. Even a board that attempts to follow its executive officer closely cannot do more than hear reports from him frequently and examine the books occasionally. In almost any bank it is usually easy to conceal crookedness in the books from the directors, because they lack the technical knowledge necessary to detect suspicious circumstances and to follow

them to their conclusions. It is hardly practicable for a bank board in one of the lesser towns or villages to employ an expert for the purpose of checking up its executive officer.

So in practice it happens that a great many of the banks are ruled by one-man power. The one man has large opportunities to commit fraud if he is inclined that way. In every country and under every banking system there will be a certain proportion of the men engaged in banking deficient enough in integrity and in wisdom to commit fraud if they get the chance. Under the United States system they too often find the door invitingly open.

Too Much Opportunity to Defraud

A high officer of a surety company, in an address at a state bankers' association meeting in 1909, said: "As a matter of fact, the losses under bank or other employees' bonds sustained by surety companies are not so much due, primarily, to the malicious dishonesty of employees, as, on the contrary, to the absence of an effective system of accounting on the part of the bank; in other words, they are due to too much freedom of action being accorded the employee — too much opportunity. As far as possible bankers should make it impossible for their employees to embezzle money. They owe it to their employees, because it is opportunity that makes the thief."

Now there is not, and could hardly be, any uniformity of system or practice among the thousands of banks in the United States. Being independent, each office orders its routine and affairs to suit itself. Generally the banks aim to have as little red tape as possible. The consequence is that in a large proportion of the offices, perhaps in a majority of them, business is conducted on loose lines, with scarcely any pretence of following rules and regulations.

The Ill-Regulated Offices

I concede with pleasure that there are many banking offices in the United States wherein the most efficient safeguards against fraud by the employees are continually in force. Especially in the great banking offices of the larger cities is the routine ordered so as to make defalcation difficult and immediately dangerous. Also many of the banks in the smaller places conduct their office work strictly under proper rules and regulations. But the point is that the system ensures that there will be all the time hundreds, if not thousands, of banking offices in which no proper safeguards are provided. In any part of the country one may without difficulty find offices in which there is little or no system about the work. The tellers are not isolated; other clerks have access to the cash and pay checks and take deposits; the tellers also are permitted to enter deposits in customers' pass-books. The one-man-ruler is a veritable czar; the clerks under him feel that they are as much his servants as servants of the bank. When he does questionable things there is no one to stand up against him; no one willing to risk loss of position for the sake of protecting the bank. Each one of the employees, being dependent on him for promotion and increase, is intent upon keeping his good will. If a clerk stumbles upon something suspicious, there is often no safe way of discovering whether or not a fraud is on the way. To say anything to the directors would be risky, as they might not attach any importance to the story; and if they did it might turn out that no fraud had been committed, and the too zealous clerk would likely lose his position.

External Examination as a Preventive of Fraud

Some readers will perhaps think it strange that no mention has as yet been made of the examinations of the

banks by the Comptroller's officers as a preventive of fraud. The truth is that these examinations cannot prevent defalcation. The examiner may discover a fraud after it is committed; that is about all he can do. He calls at the bank only about twice a year, and his visits do not last more than a day or two days. A more thorough examination or inspection than that of the regular bank examiners is provided by the clearing-house associations of some of the principal cities. Regarding the examinations by the Chicago Clearing House officers, Mr. James B. Forgan, the president of the First National Bank of Chicago, had this to say, in addressing the Michigan Bankers' Association in July, 1909: "The (regular) bank examiners go round on an average, I believe, of twice a year. In Chicago, with one examiner with five assistants, it takes fully a year to get around the banks. That shows you how much more thoroughly we go into the business than the Government does. It takes us the whole year to get around, but we go in with the key so far as supervision is concerned—the key to lock the stable after the horse is gone."

Prevention Must Come from Within

When a thorough system of examination like that of the Chicago Clearing House cannot, on the admission of an expert of Mr. Forgan's standing, prevent a high officer of a Chicago bank from absconding with the bank's money, it is idle to expect the Government examinations to prevent defalcations. Every intelligent banker knows that the preventive force must reside in the bank itself. It must be there, in active working order, every day and all through the year. That is exactly what the branch system of banks makes possible. If the banking business of the United States were in the hands of some two hundred banks, each of which operated numerous branches, it would come about, in all probability, that every bank-

ing office in the country would be subjected to a scientific code of regulations, designed to prevent or hinder frauds by the employees; and the manager or head of every branch would be subjected to checks which would make it difficult, if not impossible, for him to rob the bank without being at once detected. The experts in the head office devise the rules and the routine that shall prevail, and every branch belonging to the system must order its affairs in consonance therewith. When the bank's inspectors go round one of their important duties is to report on the way in which the rules are observed. An office in which discipline is not enforced, or regulations not observed, is looked upon as being specially open to loss by defalcation.

Checks Upon the Branch Manager

At each branch there is appointed, in addition to the manager, an officer styled the accountant, who ranks immediately after the manager, and who is responsible conjointly with him for the proper conduct of the office. Dual custody of all cash and securities is provided for and enforced. Two locks, each with an individual key, or two combinations, are provided for the compartment of the safe used by these officers. Each has a key or a combination. Nothing may be put in or taken out except in the presence of both. All checks, drafts on correspondents, etc., must be signed by both. Thus the branch manager has not the same opportunity to steal the bank's money as the heads of many independent local banks possess. His accountant and the other men all feel that they are in the service of the bank, and that their allegiance is due to it rather than to the manager. All of them, perhaps, expect that they will be branch managers themselves before very long. In nearly every case they can be depended on to detect and frustrate attempts of the manager to defraud the bank.

Checks Upon Minor Officers and Clerks

Then, as regards frauds by minor officers and clerks, an elaborate system of checking, calling off, switching of men from one post to another, and from one branch to another, is a necessary part of the operation of every large branch bank. Owing to this it is the case that a given amount of business transacted by a Canadian branch bank occasions more labor than the same business would in a United States bank. But it is reasonably certain that the relatively greater freedom from frauds and defalcations, and the consequent higher estimation in which the public holds the banks, constitute a sufficient compensation for the larger outlay thus occasioned.

Effects of Internal Inspection

In addition to the interior mechanism of the branch itself, designed to stop frauds, there are other potent factors working in the same direction. One is the system of inspection, which is superior to anything of the kind that could be devised under the system of isolated single-office banks. It was remarked that the inspection by the clearing-house associations in the United States could be taken as more thorough than the inspection by the Government. It can fairly be said that owing to the existence of the branch system the inspection of the branch offices, as practised in Canada, is more thorough again than the inspection practised by the clearing-houses in the large United States cities. It is so because the Canadian examiners are, like the clearing-house examiners, experts in banking, and because they have a more intimate knowledge of the affairs of the offices they inspect, and a greater power and authority to correct loose practices. The bank examiner in the United States, whether employed by the Government or by the clearing-house, is an outsider; and the officers and clerks of

each bank he examines will be careful to keep many important details out of his ken. The inspector who overhauls the Canadian branch is in the service of the bank, and is therefore entitled to the most intimate knowledge of the affairs of the branch. He is in the confidence of the chief executive, and he comes to the branch well posted as to the business done and the relations with the larger customers.

Power of the Bank's Own Inspector

Then, as to recommendations: a Federal or state government examiner, or a clearing-house examiner, may make recommendations that certain things be done, and if the matters are regarded as important, he may demand and perhaps get compliance with his wishes sooner or later; but as regards matters of routine, and the minor details of daily practice, he obviously has not as strong a call or right to interfere as has the branch-bank inspector.

As a subsequent chapter will deal with the whole question of bank inspection or examination, and with the question of the supervision of the head offices of branch banks, it is not necessary to enlarge upon those matters now. Enough has been said to show that the placing of all the bank offices under uniform sets of rules as to daily practice, and the enforcement of an efficient internal inspection, constitute an important deterrent influence against fraud by the employees. Under the branch system this factor would necessarily be developed to a high degree of efficiency; it never can be so developed under the present system of single-office banks.

Mutual Guarantee of Fidelity

It has been mentioned that more reliance can generally be placed upon the employees of a large branch bank to stop frauds which are attempted by the active heads of the banking offices because they have a keener sense

of the fact that they are in the service of the bank, and not of an individual. In connection with the Canadian service there is another thing which tends to make all ranks of the employees keen and zealous to stop frauds by their fellows, whether those fellows be superior in rank or not. Quite a large proportion of the banks have what is known as a "mutual guarantee fund" designed to ensure the fidelity of the men. Whenever a bank institutes a fund of this kind, all the men are called upon to join it; and no other bonds or sureties for their fidelity are required from them. Each man is bonded in the fund for whatever sum his position calls for, and out of his monthly salary he pays a rate per cent. as premium (usually about half the rate a fidelity company would charge). Then the bank itself pays into the fund an annual sum, debiting its current profits therefor. A number of the banks operate their guarantee funds as conditional savings accounts. Thus the men pay in their monthly assessments, which go to the credit of the individuals contributing. So long as no defalcations occur the balance standing at the credit of each employee is regarded as being conditionally his property. If he contributes for a specified time, generally about ten years, he may, on retiring from the service, withdraw the whole of his payments provided no defalcations have taken place. Suppose an employee steals a certain sum and no recovery is made. The bank charges the loss up to the fund, if it does not exceed the amount of the bond carried by the defaulter, and it is distributed among all the employees pro rata to the amounts of their respective bonds. Each man has thus a direct personal interest in preventing fraud by his fellows or superiors. Each one knows that a certain share of the loss will come out of his pocket if one of them succeeds in robbing the bank, and the knowledge tends to sharpen his watchfulness and to stiffen his attitude whenever he chances upon suspicious circumstances.

The Pension Funds

Then the pension funds constitute another factor making for loyalty and efficient service on the part of the employees. Each man pays his monthly premium into the bank's pension fund; the bank pays in a yearly amount out of its profits—its payment being equal to or exceeding the aggregate of the staff payments during the year. Out of the fund so accumulated a regularly graded system of pensions is kept up, under which every employee who has served the stipulated minimum term (usually fifteen years or twenty years) may claim a pension upon retiring or upon reaching the age limit. In the case of the pension fund also an account is kept for each member of the staff, his payments being credited therein. If he leaves the bank or is dismissed, providing it is not because of a defalcation or shortage, he may withdraw the whole of his payments with compound interest thereon.

There is no doubt that these mutual funds or organizations, in which all grades of the employees participate, as well as the banks themselves, operate potently to keep the banking service clean and efficient. They are hardly practicable or available for a large number of banks under the single-office system. True, there are some institutions in the céntres with staffs large enough to permit the establishment of mutual systems of pensions and of fidelity insurance; but when the whole number of a bank's employees is less than a score, and that is the case with great numbers of banking institutions, it is obviously impracticable to inaugurate either a pensioning or a guaranteeing arrangement based upon the mutual idea.

Swindles, Burglaries, and Hold-ups

It is necessary to remember that banks are often the victims of frauds perpetrated by others than their employees. Swindlers of all kinds, to say nothing of burglars and hold-up men, are always on the watch for

opportunities of preying upon the banking community. Though there is a considerable amount of sympathy felt by the general public for a bank which has been broken into and robbed by desperadoes, the sympathy of the public usually contains a measure of contempt when the unfortunate banker loses his money through being duped by an artful swindler. It would not be fair to strive to make an argument for branch banks out of the numerous burglaries and hold-ups perpetrated upon the banks in the United States. These occur largely from causes altogether beyond the control of the bankers. When they are numerous and persistent in any district, it is likely to be because the civil laws are not enforced there in a manner to earn the respect of the desperate criminal classes. At the same time it might be observed, *en passant*, that it is quite probable that laxity of the banks in guarding their treasures is at the bottom of a certain proportion of the successful burglaries. Among so many banks it must be that there are always a considerable number of which the defences are inadequate or carelessly manned. For example, it is reasonably safe to estimate that among the twenty-two thousand odd banking offices are some hundreds with inferior vault and safe protection. Many of the so-called banks, especially in the West, might with more propriety be styled real estate offices or insurance offices. Even in the East there are banks which occupy a corner in a store or other business place, and are separated from the crowds that frequent the store counters by the flimsiest of railings. Some have poor vaults, and safes that could hardly have been considered up to date twenty years ago. Banks with such defences are of course easy marks for burglars.

How Branch Banks Would Defend Themselves

If there were large branch banks operating in the Union it could be taken for granted that the executive officer of each one would see to it that every branch of

his bank was provided with a properly constructed vault and a modern or up-to-date safe. In the Canadian service the employees are commonly liable for guard duty, which means that one or perhaps two of them will be required to sleep on the premises at night, fully armed of course. Some banks insist upon minute details at practically all branches in their scheme of defence against burglars. So it can be said that under the branch system the defences against the burglar-enemy would be kept up all along the line, and it might be that the newspapers would have fewer burglaries to report.

Then it is well known that banks in all countries are obliged to be constantly on guard against swindlers of various kinds. These swindlers may attempt to defraud through passing an isolated spurious item, or they may plan to bring off a more extensive coup. There is swindling of an important kind sometimes in the department of loans and discounts. Because of their systematized handling of the loans and discounts, and the universal practice at all offices of the most modern safeguards against frauds, the branch banks are less liable on the whole to be victimized.

Defalcation Often Ruins Small Banks

Every once in a while one hears of a bank in the United States being closed because of crippling losses through frauds or bad loans. Under the branch system there would not be so much likelihood of the losses being incurred; and if they did occur they would not be so apt to result in the closing or crippling of the bank.

Unnecessary loss of bank funds through the depredations of burglars and swindlers, and also through lending to dishonest or incapable customers, plays its certain part in decreasing the confidence which the public has in the banks. It does more: It affects the productivity of capital invested in banking, and influences the rate of interest which borrowers of all kinds must pay.

II

THE COST OF SINGLE-OFFICE BANKS

Operating Twenty-two Thousand Organizations

THE next count to be pressed, in the indictment of the local single-office banks, is their excessive cost. One need not be a banking expert to see plainly that twenty-two thousand separate organizations, each with its cashier, vice-president, president, board of directors, and full paraphernalia of executive control, must cost more, in respect of administration and operation, than would two hundred organizations with an average of one hundred and ten branches to each. In the latter case, at every one of the twenty-two thousand branches, one officer—the branch manager—would perform the functions which under the non-branch system call for the services of cashier, vice-president, president, and board. If it be supposed that a change were to take place on a certain fixed date, by Act of Congress, from the independent system to the branch system, and the twenty-two thousand independent offices were to become twenty-two thousand branches of two hundred great banks, it would mean the abolition of about twenty-two thousand presidents, twenty-two thousand vice-presidents, and (allowing an average of six directors to a bank) of about one hundred and thirty thousand directors.

Operating Two Hundred Branch Banks

Allowing to each one of the two hundred branch banks an average of fifteen directors, the requirements, in the

way of representation for the stock comprising the capital of the banks, would be three thousand directors, two hundred vice-presidents, and two hundred presidents. Can anybody doubt that there would be a substantial annual saving effected? There is reason to suppose that the saving might amount to between $15,000,000 and $20,000,000 a year. The higher figure would represent an average net economy of a little over $900 per year for each banking office; and that does not seem an extravagant estimate. Of course it is to be remembered that the cost of the two hundred executives required under the branch system would be an important item. There would be some executive officers commanding very high salaries; there would be the cost of inspection of branches and the cost of the other executive machinery necessary for operating large branch systems. The branch system would also necessitate the consumption of a considerable amount of stationery in the numerous reports and statements which the branches would be continually obliged to furnish to the head offices; and the preparation of those statements would necessitate extra labor at the branches and so increase the item of clerk hire. If it were not for these items perhaps the annual saving effected through centralizing the management and control might be placed well above the average of $900 per banking office. I venture, here, to suggest that an executive capable of managing a large branch system could probably be had at a cost not exceeding very much, if at all, that now incurred in the administration of any one of several large and powerful banks in New York and Chicago which have but the single office.

Practice of Branch Banks Would Be Better

Even if it could be shown that it would cost fully as much to administer and operate, with branch-bank machinery, the volume of business now handled by the

single-office banks, it might still be argued that the change would result in a vast economy. For at hundreds of places the reins would be taken from weak, incapable hands, and assumed by strong and able men. Nobody has any idea as to the amount of the annual losses from bad loans and from bad banking methods under the present system. It must be an appalling total. I am aware that in Canada the best conducted banks, with all the skill and experience of their officers, are not able to escape heavy losses from bad debts. Any year a large Canadian bank might have to write off $100,000, or double that sum, on account of loans that turned out badly. And in their cases there are no local boards to insist upon the bank's funds being applied to bolster up sickly local industries. It would seem that the losses from this cause in the United States must amount to many times the Canadian total. Most of the losses so incurred never find their way into published statistics. They are written off before the annual meetings, and serve to reduce the published profits, in some cases to wipe them out altogether. It is only when a bank's losses are so severe as to impair its capital or its safety, and the stockholders are unable or unwilling to repair the breach, that the public comes to a knowledge of its misfortunes. It should be clear that when the shareholders' losses are excessive the fact malevolently affects both bank borrowers and bank depositors. Bearing this in mind, we may now proceed to examine the record of the single-office banks in regard to insolvencies.

The Record of Failed National Banks

The 1909 Report of the Comptroller of the Currency states that between 1865 and 1909 five hundred and eight national banks were placed in the hands of receivers. Twenty-four were restored to solvency and permitted to liquidate or to resume business. At the date of the report

sixty-eight receiverships were still open. Thus there were four hundred and sixteen insolvencies of which the affairs had been finally settled. It is hardly necessary to go back so far as 1865. A better and fairer illustration can be had through taking the record of insolvencies since 1890. That will give a period covering the 1893 panic, the years of depression that followed it, and the succeeding era of prosperity which continued into 1907. Following is a table of the insolvencies among the national banks since 1890 (see page 356 of the Report of the Comptroller of the Currency, 1909):

NATIONAL BANKS CLOSED

Year	Number of Banks	Amount of Claims Proved	Assets Estimated Doubtful	Assets Estimated Worthless
1891	25	$ 6,780,646	$ 3,578,041	$3,005,495
1892	17	10,860,890	7,152,617	1,938,735
1893	65	14,434,105	10,164,830	7,217,412
1894	21	3,771,200	3,390,690	1,846,149
1895	36	6,078,734	5,477,277	3,477,914
1896	27	6,724,197	4,792,160	3,187,315
1897	38	19,576,398	8,787,653	8,664,997
1898	7	2,625,988	800,403	1,717,968
1899	12	1,518,124	875,683	704,842
1900	6	5,579,842	4,733,498	1,740,629
1901	11	5,774,274	2,810,945	516,811
1902	2	345,665	267,718	164,152
1903	12	3,794,993	1,839,073	925,209
1904	20	5,044,157	3,125,538	1,711,712
1905	22	10,023,442	5,658,029	1,831,418
1906	8	1,111,302	616,501	811,619
1907	7	4,453,825	3,180,517	453,133
1908	24	13,797,606	13,194,357	2,646,615
1909	9	1,693,472	852,826	976,271
	369	$123,988,860	$81,298,556	$43,538,396
An. average,	19	6,525,729	4,278,766	2,291,495

18 banks were restored to solvency.
7 banks were formerly in voluntary liquidation.
4 banks mentioned above failed for the second time.

National Bank Depositors Lose $1,155,706 Per Year

This table includes all the national banks closed during the period under review. The amount of loss ultimately

inflicted upon depositors cannot be stated exactly, because among the three hundred and sixty-nine banks taken into the table are the institutions of which the assets had not been liquidated at the date of the Comptroller's report. But it is possible to estimate roughly what the result will be when all the receiverships are closed. The Comptroller gives, on page 83 of his 1908 report, the results of liquidation of the four hundred and one banks of which the affairs were finally settled at the date of the report. The net loss to depositors was 17.71 per cent. on the amount of claims proved. Assuming that there will ultimately result a loss of 17.71 per cent. upon the $123,988,860 of claims proved, as shown in the above table, the loss works out $21,958,427, or an average of $1,155,706 per year.

The two columns "Assets Estimated Doubtful" and "Assets Estimated Worthless" are given because of the light they throw upon the matter of the capability and honesty of the bankers whose institutions were thrown into insolvency. The assets claimed by the three hundred and sixty-nine banks in the table were classified as follows by the receivers on taking charge:

Estimated good,	$84,831,904	=	40 per cent.
Estimated doubtful,	81,298,556	=	39 per cent.
Estimated worthless,	43,538,396	=	21 per cent.
	$209,668,856	=	100 per cent.

It is a well-known fact that the assets of a bank becoming insolvent usually look their best on the day the doors are closed. Except in the cases of a few special items they generally deteriorate steadily in value as the liquidation proceeds; and it is necessary to revise in a downward direction the estimates of what the estate will produce.

Losses Through Bad Loans and Investments

By studying the results of the liquidation of those failed banks of which the receiverships are closed, one

may arrive at an estimate of the loss that will result from the liquidation of the $209,668,856 of assets here referred to. In his 1908 report the Comptroller gives the result of liquidation of the four hundred and one receiverships which had then been ended (see page 383). Their assets on suspending were thus classified:

Estimated good,	$92,180,219
Estimated doubtful,	82,525,637
Estimated worthless,	51,702,219
	$226,408,075

After suspension additional assets amounting to $36,-024,761 were received by the liquidators, making altogether $262,432,836 which came into their hands. The loss on assets compounded or sold under order of court amounted to $98,013,857. From the whole mass of assets the receivers collected $129,047,946, and they allowed $19,899,-259 in offsets, making total realizations of $148,947,205, or a trifle over 56¾ per cent. of the amount which came into their hands.

Now, in the cases of the three hundred and sixty-nine banks that have failed since 1890, the receivers acquired $32,056,623 of additional assets after suspension. Adding this amount to the $209,668,856 of assets which were there when the doors closed, there results the sum of $241,725,-479 for the receivers to account for. Assuming that 57 per cent. will be collected (which is a slightly better ratio than actually occurred in the cases of the terminated receiverships up to 1908), the realizations would amount to $137,783,523, and the worthless or nearly worthless residue would be $103,841,956. Let us put these results into a shape to be understood by the man in the street. They mean that in the nineteen years ended October, 1909, three hundred and sixty-nine national banks failed. On closing their doors they had an aggregate of $209,668,-856 of assets representing their loans and investments.

These loans and investments, after being fortified by the $32,056,623 of additional assets which the receivers managed to get, presumably from debtors and shareholders, yielded, or rather will yield on the completion of the receiverships, only $137,783,523.

Losses of Banks that Did Not Fail

This record was achieved by the three hundred and sixty-nine banks whose directors and shareholders could not or would not put up the cash or securities required to avert failure. If to the sum of their losses, through bad loans and investments, were added the losses made by the banks which escaped suspension "by the skin of their teeth," so to speak, or in the cases of which the directors and shareholders were forced to dip deep into their pockets for fresh capital to replace what was lost, a very formidable total would evolve.

Of these losses the principal part fell to the stockholders. As there are no means of calculating or estimating the annual wastage of capital resulting from bad loans made by the national banks, or from bad banking on their part, it is necessary to rest content with setting down the foregoing figures. So far as the creditors are concerned the table of failures shows that, judging by the experience of the nineteen years from 1891 to 1909, the people of the United States may expect that each year, on the average, nineteen national banks will be closed; that there will be locked up for an indefinite period (anywhere from six months to three years) a sum at least equal to $6,525,729, and of this sum $1,155,706 will be ultimately lost.

State and Private Bank Failures

The record of the state and private banks and trust companies is much worse. The following table of failures

of banks other than national is taken from page 58 of the Comptroller's 1909 report:

Year	Number of Failures	Liabilities	Nominal Assets
1891	44	$ 6,365,198	$ 7,190,824
1892	27	3,227,608	2,719,410
1893	261	46,766,818	54,828,690
1894	71	7,218,319	7,958,284
1895	115	9,010,584	11,276,529
1896	78	7,513,837	10,240,244
1897	122	24,090,879	17,929,163
1898	53	7,080,190	4,493,577
1899	26	10,448,159	7,790,244
1900	32	11,421,028	7,675,792
1901	56	13,334,629	6,373,372
1902	43	10,332,666	7,323,737
1903	26	4,005,643	2,166,852
1904	102	31,774,895	24,296,823
1905	57	10,273,023	6,970,345
1906	37	7,187,858	6,591,515
1907	34	22,165,448	13,037,497
1908	132	209,835,443	177,073,348
1909	60	25,190,156	15,760,177
	1,376	$467,242,381	$391,696,423
Annual average,	72	24,591,704	

I have not included in the above, seventy failures not dated, which occurred between 1865 and 1896.

Results of Liquidations

Statistics of losses to depositors are not available, but in the report it is stated that in 1896 the then Comptroller secured a list of banks which failed in each state from 1864 to 1896, and investigated the results of the liquidation. The twelve hundred and thirty-four making up this list had at suspension liabilities of $220,629,988, and nominal assets of $214,312,190. On claims proved dividends were paid to the amount of $100,088,726, or 45.4 per cent. of the aggregate liabilities. There is one circumstance which would make it unfair to apply that ratio to the liabilities shown in the foregoing table: It is well known that the large total shown for 1908 arose

through the suspension of a number of banks and trust companies of considerable importance in New York City which closed their doors during the panic, and were afterward restored to solvency through the contribution of fresh capital by their stockholders. It is but right, therefore, that any calculation of loss to depositors should take cognizance of this circumstance. Probably it will be conceded that an allowance of $100,000,000 will be ample. Assuming, then, that $100,000,000 of the liabilities shown for 1908 would be redeemed without loss, and reducing the aggregate by that amount, there remains the sum of $367,242,381 to which the ratio of 45 per cent. might apply. Thus $165,259,071 results as the probable sum of the dividends paid, or to be paid on the claims proved. In other words, the loss to depositors would approximate $201,983,310 in the nineteen years ended 1909, providing the ratio of recoveries from the assets turns out to be the same for the period 1890 to 1909 as it was for the period 1864 to 1896. If the recoveries during the period 1896 to 1909 be judged according to the ratio of nominal assets to total liabilities, the dividends to creditors would appear to amount to a less percentage of the liabilities than was paid in the period 1864 to 1896. In the earlier period—1864 to 1896—the liabilities were $220,629,988, while the nominal assets were $214,312,190, or 97 per cent. of the liabilities. In the later period—1896 to 1909—the liabilities were $387,140,017, and the assets were $297,482,442, or only 77 per cent. of the liabilities. However, I have estimated that the recoveries from 1896 to 1909 would be on the same ratio as in the earlier period.

Depositors Lose $11,786,407 Per Year

Summing up, it is seen, if these calculations are correct, that the depositors in and creditors of banks other than national have to expect in the future, judging by

past records, that there will be on the average seventy-two banks becoming insolvent every year, locking up $24,591,702 of depositors' funds; and that $10,630,701 of the locked-up funds will be ultimately lost. Consolidating the two exhibits—that of the national banks and that of the state-controlled banks—the following results: The people of the United States may expect that each year an average of ninety-one banks will close their doors, locking up $31,117,433 of their depositors' funds, and that $11,786,407 of the funds so locked up will be irretrievably lost. When the loss to depositors is so heavy as this it may safely be assumed that the loss to stockholders is very large.

Losses of Depositors in Banks Which Were Not Closed

But there are other items: Account should be taken of the special losses suffered by depositors in banks which did not close their doors in 1893 and in 1907, but which placed an embargo on cash withdrawals. In both those years, as everybody knows, a considerable number of banks refused to pay their liabilities in cash as they accrued. In one sense the suspension of cash payments represented the lock-up of a vast amount of depositors' funds. Business men and others who had funds placed in the banks for certain purposes were in some cases refused possession of their own property or were tendered payment in a depreciated medium. Many were thus prevented from carrying on their business advantageously, others from engaging in profitable enterprises. The loss which they suffered in this manner is unquestionably chargeable to the banks which refused to stand up and honorably discharge their liabilities. The discount or loss which depositors suffered, through having to use in their payments depreciated certified checks instead of the cash to which they were entitled, clearly constitutes

a grievance against the banks. If the banks had faithfully observed the law, if they had performed their part of the contract between themselves and their depositors, there could have been no premium for cash. If, in defence, it is argued that the banks could not have continued paying cash without wholesale insolvencies, the argument damns the banking system. In banking, no matter where, to suspend cash payments is the unforgettable thing; the banker who fails to respond, on the instant, to the just demand of his creditor, forfeits a measure of the respect of his fellow-bankers at home and in foreign countries, and no amount of arguing or explanation can set him right.

Losses of the Borrowing Classes

Again, it is to be observed that bank failures inflict loss upon the borrowing class as well as upon the depositors. When a bank fails and is liquidated the customers indebted to it must pay to the receiver the debts they owe it. In the cases of some borrowers other banks may be induced to take up the loans. In times of disturbance that course is exceedingly difficult; and it always happens, even when conditions are normal, that some are not able in this way to finance their liability to the failed institution, and have themselves to be sold out or liquidated, sometimes when they are quite solvent and worthy of credit. The inconvenience and loss thus suffered by the borrowing class, of which no estimate or calculation can be made, is to be added to the score.

Responsibility of the Banking System for These Losses

It is next in order to discuss the questions: How much of this annual loss, resulting from bank failures and suspension of cash payments, can fairly be charged against

the system of local single-office banks? Would the loss have been greater or less had the United States possessed properly constituted and operated branch banks such as exist in other important countries? Some idea as to the answers can be arrived at through taking account of banking results elsewhere in the Anglo-Saxon world.

In the British Isles, where the branch system prevails, failures of typical branch banks are rare. It is many years since a really important bank went down. The Barings, who stopped in 1890, were acceptors of international bills and financiers rather than a branch bank. So unusual are failures among the representative institutions that depositors using any one of the large branch banks must have come to regard the risk of loss from that source as entirely negligible. It is not so in the United States. Many depositors there cannot tell with any degree of assurance whether or not their bankers will be among the number slated to fall in each average year.

Bank Failures in Canada

Canada's experience is perhaps more in point than is that of the United Kingdom. The following table comprises all the bank failures in the Dominion between 1890 and 1909:

Year	Bank	Liabilities	Loss to Creditors
1893	Commercial, Manitoba,	$1,341,251	nil
1895	Du Peuple,	6,820,450	$1,236,511
1899	Ville Marie,	1,951,346	1,248,818
1905	Yarmouth,	479,323	nil
1906	Ontario,	15,229,685	nil
1908	De St. Jean,	556,882	*
1908	De St. Hyacinthe,	1,182,362	*

* Liquidation not completed; results to depositors not yet known.

If it were not for the bad showing of the four French-Canadian banks the record would show a total clearness from losses to creditors. With regard to the loss to de-

positors in the Banque de St. Jean it is known that it will be heavy. Putting the loss at 75 per cent. of the liabilities, we may set the total at $417,000. And if it be assumed that the Banque de St. Hyacinthe depositors lose 25 per cent., that would make another $295,000. Adding the two items to the loss suffered by depositors in the Banque du Peuple and the Banque Ville Marie a total of $3,197,329 results for the nineteen years, or an annual average of $168,280, as compared with an annual average of $11,786,487 for the United States.

As regards lock-up of depositors' funds, it is to be observed that in the case of the Ontario Bank none occurred. On the day the failure was announced the Bank of Montreal assumed the Ontario's liabilities, and at all branches paid all demands as presented. Allowing for the circumstance, the total amount locked up in the nineteen years was $12,331,614, or an annual average of $649,032, as compared with the annual average of $31,117,433 shown by the United States. Thus the average annual lock-up in the United States is forty-eight times as great as occurs in Canada; the annual loss suffered by bank creditors is seventy times as great as in Canada.

Losses of Bank Stockholders

This comparison applies only to the creditors of banks in the two countries. I should like to present a comparison of results to stockholders, but I cannot see how a fair comparison can be instituted. I am aware that an eminent Canadian banker, Mr. H. C. McLeod, of the Bank of Nova Scotia, does compare the losses of bank stockholders in Canada with the losses of holders of the stock of national banks in the United States. He presents his comparison as part of his argument for the institution of external examination or supervision of the Canadian banks.

Mr. McLeod makes the losses to national bank stock-

holders in forty-four years to amount to $100,825,239, his process being as follows:

Aggregate capital of national banks becoming insolvent (to 1908)	$82,727,420
Cash assessments on stockholders................	20,974,373
	$103,701,793
Less cash dividends returned to stockholders......	2,876,554
	$100,825,239

Then he applies this loss to the $930,365,275 of national bank capital stock outstanding in 1909, and makes the percentage of loss 11. The losses to Canadian bank stockholders in the same period of forty-four years ending in 1908 he estimates at $44,700,000; and applying the amount to the amount of capital stock in 1909, $94,471,415, he gets a loss of 47 per cent. Before commenting on these figures I might observe that when the losses as here given are applied to the average of capital for the forty-four years the results are 71 per cent. of average capital for Canada, and for the national banks 17 per cent. of the average capital.

A Prospect of Immunity from Bank Failures

There are several reasons why I consider that these figures are not suitable as a basis for comparing the losses inflicted on bank stockholders respectively by the branch and single-office systems of banks. I concede that the Canadian losses as stated may be approximately correct, but I hold that losses of national bank stockholders are understated. The figure given as representing their losses does not include the destruction of the surpluses and the profit and loss balances, and it does not include the fresh capital contributed by the stockholders of banks remaining solvent or restored to solvency. As everybody knows, the Comptroller is continually re-

quiring banks to call up fresh capital to replace that lost. Finally, it is to be remembered that in this comparison the cream of the United States system is set against the whole Canadian system. If the results for all the state banks, private banks, etc., could be discovered, I venture to say that the comparison would not be unfavorable to the Dominion, notwithstanding the fact that the Canadian banks have been free from external supervision. There seems to be some grounds for expecting that the Canadian banks will before long be placed under the supervision of an outside authority; and there is fair ground for agreeing with Mr. McLeod in his contention that the combination of branch banking, efficient internal inspection, external supervision, and care in granting charters for new banks, would very likely abolish bank failures altogether in Canada, as it appears to have abolished them in Scotland.

Reduction in Number of Canadian Banks

A fact in connection with the Canadian failure list, to which attention should be given, is that five of the seven failed institutions were small localized banks. Three—the Yarmouth, St. Jean, and St. Hyacinthe—were distinctly of the United States type. Judging by this Canadian record, with the last ten years absolutely clear, so far as the typical branch banks are concerned, the greater part of the losses shown for the United States, so far as creditors are concerned, can fairly be placed against the system of local independent banks. Also there are strong grounds for expecting, providing each country holds to its existing system, that the Canadian record will get fairer and fairer, while that of the United States will get darker and darker. The record of Canadian disasters shows that since 1890* nine banks have failed.

* The St. Stephens Bank, a small single-office bank in the Province of New Brunswick, failed early in 1910; and the Farmers Bank of Canada failed disastrously in December, 1910.

In addition, twelve were absorbed or went into liquidation, making a gross reduction of twenty-one. In the mean time only nine new banks have started. Thus a net reduction of twelve has been effected. At the present time the number of banks in active existence is twenty-seven. The requirements, in the way of capital subscriptions and cash payments on stock, are so onerous—being purposely made so by the Dominion Parliament—and the existing banks cover the country so completely and meet the needs of the commercial community so fully, that it is a most difficult matter to start a new bank in Canada. Thus the situation in British North America is tending strongly toward further reduction of the number of banks and toward further increase in the size and strength of the individual institutions. By-and-by there will be, very likely, perhaps twenty great banks, each one so strong and well managed as to reduce very much the danger of failure.

Rapid Increase in Number of United States Banks

Look next at the tendency prevailing in the United States, and mark how different it is. Following is the record for the past five years of the number of banks in operation, as taken from the Comptroller's reports:

NUMBER OF BANKS IN THE UNITED STATES

	1905	1906	1907	1908	1909
Savings,	1,237	1,319	1,415	1,453	1,703
Private,	1,028	929	1,141	1,007	1,497
State,	7,794	8,862	9,967	11,220	11,319
National,	5,833	6,199	6,544	6,853	6,893
	15,892	17,309	19,067	20,533	21,412

(I have not included loan and trust companies. There were ten hundred and seventy-nine of them reporting to the National Monetary Commission in 1909.)

The mill is turning out new banks at the rate of thirteen

hundred and eighty per year, and as yet there are few indications that its activities will be lessened. No fair-minded person can deny that a large number of the new banks created every year are in the hands of incompetent or inexperienced men. Some are in the hands of downright rogues. What hope is there that supervision, examination, or inspection can stop or reduce the practice of bad banking, the making of bad loans, when the business is kept wide open for all comers?

Diversion of Bank Resources into Bond Investments

But, though the creation or coming into existence of such a vast number of new banks, many of which will be ill managed, is thus certain to result in the yearly recurrence of frightful losses, there are no other means of providing facilities for the smaller places. It is hardly to be expected that a bank which is organized in a little place of eight hundred or one thousand population will be able to command the services of officers who understand the principles that should govern the business. Yet unless it is started the locality must go without a bank. The branch system supplies banking offices for places even smaller than this and ensures strength and good management at all points.

There is another respect in which the single-office banks of the United States are exceedingly costly. In his address delivered in 1908 before the Economic Club of New York, in which he styled the United States banking system "the worst in the world," Andrew Carnegie quoted Mr. Fowler, the then chairman of the Finance Committee of the House of Representatives, as stating that the loss to the country, through the diversion of banking capital into Government bonds, amounted to $150,000,000 annually. Most bankers know that one of the chief reasons why this costly diversion of capital has continued to this day is the existence of such a multitude of banks, of all

degrees of size, soundness, and strength. It is manifestly impossible, even for experts, to tell which might safely be trusted. Therefore, it has been considered essential that for the issues of bank notes to serve as currency, and for the deposits entrusted to the banks by Government, some specific security should be required; and Government bonds have seemed best fitted for the purpose. Of course the evil of the arrangement lies in the fact that the Government has appropriated to its own use a huge loan fund that would, under other circumstances, have been available for commercial borrowers. The safety with which the national bank notes have been endowed has been acquired at a considerable cost; for, as the national banks must buy Government bonds in amount at least equal to their outstanding note circulation, their note issues do not permit them to increase their loans to the public by a single dollar. In Canada, owing to its note-issuing rights, each bank's power to discount for its customers is increased practically by the amount of its note circulation, less the cash reserve which experience teaches it to hold against the notes—not more than 30 per cent. This means much to the borrowing customers of the Canadian banks, and consequently to the Dominion's trade.

Classification of Bank Resources

The matter of the diversion of banking capital into Government and other bonds goes deeper than the note circulation. Besides furnishing bonds as security for Federal Government deposits, the banks are obliged to provide bonds as security for state government deposits, and in some states, for the deposits of municipalities. The system of banking itself induces a further and entirely voluntary investment in bonds and stocks in the following manner: A single-office bank, established in a place where deposits exceed loans, and there are many such places in the country, invests a considerable part of

the surplus in bonds, whereas, under the branch system, such surpluses would be utilized to make advances to commercial borrowers at other points where the natural demand for loans exceeded the supply of deposits. The tendency seems to be in the direction of requiring and encouraging the banks to buy ever more and more bonds for one purpose and another, until there promises to be little left for what should constitute the bulk of their resources—commercial paper. The following table, compiled from the summary of special reports obtained for, and compiled by, the National Monetary Commission, shows how large a proportion of the assets of the banks is invested in bonds and stocks, and loans on bonds and stocks:

TWENTY-TWO THOUSAND FOUR HUNDRED AND NINETY-ONE BANKING INSTITUTIONS—28TH APRIL, 1909

United States bonds	$ 792,787,711
State, county, and municipal bonds	1,091,541,455
Railroad bonds	1,560,006,360
Bonds of other public service corporations	466,526,687
Other bonds and stocks	659,873,561
Foreign securities	43,706,440
Total bonds and stocks	$ 4,614,442,214
Loans on demand secured by collateral	1,939,634,898
Loans on time secured by collateral	2,036,358,417
Total resources applied to bonds and stocks	$ 8,590,435,529
Real estate, other than premises	95,377,084
Real estate mortgages owned	1,378,701,565
Loans on real estate mortgages and liens	1,127,276,405
Grand total applied to bonds, stocks, and real estate	$11,191,790,583
Grand total other loans and overdrafts, presumably mercantile	4,891,246,403
Total resources	21,095,054,420

Proportion resources applied to bonds and stocks	41 per cent.
Proportion resources applied to real estate	12 per cent.
Proportion resources applied to mercantile loans	23 per cent.

In this table I have assumed that all loans under the following headings represented mercantile advances—*viz.*:

"On demand, unsecured by collateral," "On time, with two or more names unsecured by collateral," "Not classified," "Overdrafts, secured and unsecured."

Canadian Banks' Mercantile Loans Relatively Larger

The pitiful proportion of banking resources applied to commercial discounts is seen at once when comparison is made with Canada. Practically the whole of the banking business of the Dominion is in the hands of the chartered banks, now twenty-seven in number, with some twenty-two hundred branches. On April 30, 1909, the banks then reporting to Government made the following showing:

CANADIAN BANKS 30TH APRIL, 1909

Dominion and provincial Government bonds........$	10,419,082
Canadian municipal, and British, Foreign, or Colonial public securities........................	21,122,206
Railway and other bonds.......................	51,349,556
Total bonds and stocks...................$	82,890,844
Call and short loans on bonds and stocks, Canada...	50,213,960
Call and short loans on bonds and stocks, elsewhere.	114,493,570
$	247,598,374
Current loans and discounts Canada (mercantile)....$	524,168,988
Total resources..................................$	1,025,015,613

Proportion resources applied to bonds and stocks.......24 per cent.
Proportion resources applied to mercantile loans........51 per cent.

It will be easier to understand what the diversion of banking resources into bonds, stocks, real estate loans, etc., means to the commercial and industrial interests of the United States when it is explained that if the same proportion of the banking funds were applied to mercantile discounts as is so applied in Canada the United States banks would hold $10,758,477,754 in commercial paper instead of $4,891,246,403, as shown in the table. In other words, the amount would be more than doubled.

It may be objected by some critics that inasmuch as

the figures for the United States institutions include the reports of savings bank and trust companies the holdings of those institutions in the Dominion should be taken into the account. I might explain that practically five-sixths of the savings bank funds in Canada are held by the chartered banks, and that the Canadian trust companies, though they hold some deposits, may not transact a banking business. However, it will be interesting to include the deposits of all these outside institutions and see how the percentages are affected. The deposit holdings of the two departments of the Government savings banks, of the two special savings banks in the Province of Quebec, of the loan and mortgage companies, and of the trust companies would probably have amounted in April, 1909, to $146,000,000. Now I shall assume that the whole of this outside fund was invested in bonds, stocks, and real estate, and in loans on them. On that basis the proportion of Canadian banking resources applied to bonds, stocks, and real estate becomes 34 per cent.; and the proportion applied to mercantile discounts, 45 per cent.—the latter being still nearly double the proportion shown by the United States.

Effects of the Diversion of Capital

The diversion of this immense sum has, of course, proved a great convenience for the governments and corporations issuing securities. It has delivered them from the necessity of applying to Europe for much capital. Had they been obliged to do so, they would doubtless have been forced to render a stricter account of their affairs. But it is not difficult to see that the diversion has placed a fearful handicap on the smaller and weaker members of the mercantile and industrial community. The rich and powerful corporations can get the banking accommodation they require. Not so the little traders and factory owners. If there is a shortage they are the ones who must do without.

III

THE PANICS

Frequency of Panics in the United States

BEFORE passing definitely into the consideration of the relations existing in normal times between the banks and the general public, it will be advisable to devote a chapter to the subject of the panics, and one to a discussion of the conditions of banking service. I have already referred briefly in the introductory chapter to the panics of 1893 and 1907. On both occasions cash payments were suspended quite generally throughout the Union, bank failures were numerous, the banks ceased for a time to perform their ordinary functions, and financial conditions were entirely disorganized. Foreign bankers having funds on deposit with the greatest banks in the United States were obliged to explain to their clients who purchased drafts that the drafts would be paid not in cash but in a depreciated medium. No patriotic American who understands what really happened on the two occasions, 1893 and 1907, can think of either year without shame and humiliation. If it were possible to point to other great countries in which at any time during the same period the banking institutions failed in the strict observance of their legal obligations, and ceased to extend the customary support to the industrial and mercantile interests of their country, the sense of humiliation would be appreciably lessened. But even this comfort is denied. Not a single one of the other great countries has had its financial honor tarnished in

recent years by a general banking suspension. Even among the lesser states a general suspension is a most uncommon occurrence. So far as Anglo-Saxon countries are concerned the only occurrence of that nature in the last forty years was the Australian breakdown in 1893. For some years prior to that trouble the Australian banks had been advancing heavily on land security, and had been actively canvassing for deposits in England and Scotland to provide the funds. When the disturbance of 1893 finally reached the Antipodes it caused the stoppage of all the banks save one. In the subsequent reconstruction depositors in some of the suspended banks were obliged to convert certain classes of their deposits temporarily into stock.

Canada's Immunity from Panics

In Canada, notwithstanding that the commercial and financial interests of the country are always closely involved with the United States, no disturbance whatever took place either in 1893 or 1907. This is the more remarkable inasmuch as at the later date, when the panic struck New York, the Canadian banks had a large part of their reserve money employed there in the shape of call loans and bank balances. The total so employed on September 30, 1907, was approximately $60,000,000. Yet in both panics, at every banking office in the Dominion, business went on in the regular way. Depositors drew cash as they wanted it; borrowing customers discounted fresh paper and renewed old paper with the same freedom as they had three and four months before. The banks did not even exact the fifteen days' notice on time deposits to which their contracts entitled them.

Not only did they care for the industrial and mercantile interests of the Dominion, and maintain Canada's financial honor in the eyes of the world, but they rendered valuable assistance to many trading and manufacturing concerns

in the states immediately south of the international boundary. At such places as Niagara Falls, Detroit, Buffalo, St. Paul, Spokane, Seattle, the notes of the Canadian banks proved exceedingly useful during the time the currency famine prevailed. Also a number of American concerns in good credit were able to save themselves from insolvency or their businesses from disorganization through negotiating with the Canadian banks the loans which their home institutions could not or would not grant. General suspension of banking payments is something Canada has not seen since the hard times of 1837. For over seventy years the chartered banks have stood up honorably, meeting their liabilities in cash as they accrued.

Explaining the Panics

But it is time to consider some of the explanations that have been offered as to the peculiar susceptibility of the United States to banking panics, and the peculiar destructiveness of the panics that occur. One body of opinion has it that certain powerful interests in the great centres were guilty of wilfully engineering the disturbances in order that they themselves might derive personal gain. It is not my intention to waste any time discussing so foolish a contention. Any man who advances it, seriously believing it to be true, brands himself as ignorant of financial conditions, and any man who advances it, knowing it to be false, brands himself as a scoundrel.

Another explanation is that the country has suffered peculiarly in this respect because the people have been guilty of greater excesses, because they have offended more seriously against certain important economic laws, than have the people of other countries. Those who believe that this explanation covers the matter satisfactorily dilate upon the ugly instances of violated trust by parties in high standing which are made public from time to time, the contemptuous disregard manifested by the

same parties for some of the commonest laws of decency and honor, upon the successive bursts of wild speculation in which Wall Street indulges, and upon the enormous extent to which floating capital is converted into fixed capital whenever prosperity prevails. "So," they conclude, "as we are worse offenders than other nations in these matters it is but right that our punishment should be greater." They accept the chastisement as in some measure the hand of God, and in some measure the price paid for an exceptionally rapid industrial and political development.

It would be fatuous to dispute the strength of this contention. When the public learns that men with honored names, who sit at the boards and in the official chairs of great corporations, have been guilty of plundering the trusts they were paid to protect, the circumstances must have a weakening effect upon credit in general.

Single-Office Banks the Real Cause of the Panics

With regard to the undue prevalence of the speculative spirit it is well to remember that in the United States values, on the whole, are increasing constantly and rapidly; and wherever that is the case the speculative spirit is sure to be strongly in evidence. Also it is well to bear in mind, in reference to the losses experienced in the stock markets by ignorant outsiders, that in all the world's centres the capitalist-professionals look upon the amateur speculators as, to some extent, their lawful prey. There is a body of expert observers, apparently steadily increasing in numbers, who, while conceding that these things have an important effect as producers of disturbances, are inclined to regard them as being after all subordinate causes. They place upon the banking system of the country the chief blame for the special troubles which the United States suffers. As the Republic is the only great country in the world to experience banking

suspension in recent years, so it is the only great country in which the banking business is in the hands of small, single-office institutions.

Fifty, seventy-five, and one hundred years ago destructive panics were of frequent occurrence in England. Thus there was the suspension of the Bank of England during the war with France in the closing years of the eighteenth century, in which case cash payments were partially resumed in 1816. There was a great banking crisis in 1825, during which sixty-three country banks went down. There was a very considerable pressure in 1836, and in 1847 a panic of the first magnitude was encountered. The American breakdown of 1857, coming upon an unhealthy state of affairs in the United Kingdom, produced another great panic in that year. Still another came in 1866. Since the beginning of the last quarter of the nineteenth century there has not been a single banking panic in England in which credit was broken down.

England's Experience with Small Local Banks

Now let us review banking conditions in England during this period of one hundred years. In Macleod's *Theory and Practice of Banking* it is stated that at the close of the eighteenth century a multitude of country banks started up in all directions. "In the year 1797 they had been reduced to two hundred and seventy; in 1808 they had increased to six hundred; and in 1810, when the Bullion Committee was appointed, they amounted to seven hundred and twenty-one.

"In 1811 they were seven hundred and twenty-eight; in 1813 they had risen to nine hundred and forty."

One of the leading English financial papers recently remarked, in an article on American banking, that the system now in vogue in the United States is similar, in some important respects, to that prevailing in England

one hundred years ago. The description in the *Theory and Practice of Banking* shows clearly where the similarity lies. Those English banks which were coming into existence by scores a hundred years ago were little local banks of the American type. Though some of them operated branches, the operations of each were confined, as a rule, to one small district. The Act of Parliament which confined the right of note issue, outside of the Bank of England, to partnerships not having more than six members operated to encourage the creation of small local banks, just as the virtual prohibition of branches operates in the same direction at the present day in the United States.

Development of Large Branch Banks Increases Financial Stability

It is noteworthy that in the last half of the nineteenth century the number of banks in England and Wales has been greatly reduced. The process of centralization has been especially rapid in the last quarter of the nineteenth century and in the first decade of the twentieth century. In less than thirty years the number of banks (in England and Wales) has been reduced from one hundred to fifty, chiefly through amalgamations and absorptions.

I do not presume to say that the disappearance of the hundreds of little local banks, by absorption, failure, and liquidation, accounts by itself for the comparative immunity from serious banking convulsions enjoyed by Great Britain in the last thirty years; but I do contend that the change in the character of the banks has played a very important part in making the record cleaner. At any rate, when the little banks existed in large numbers there was serious trouble in the banking world once in every decade; and since the business has passed from their hands into those of the strong branch banks there has been no general banking breakdown. Look at the Baring crisis in 1890 for example, and im-

agine what would then have happened in England if the business of the country, instead of being in the hands of the great joint stock banks with their numerous branches, had been in the hands of thousands of small local concerns. It is very easy to see that instead of aiding the Bank of England at the difficult juncture, the small banks would have vastly increased its troubles, as a great many of them would have clamored for advances, while at the same time clutching all the cash they possibly could. But, as everybody knows, the support which the joint stock banks gave the Bank of England saved the situation.

The Panic of 1907

However, there is no need to go abroad for proofs that a system composed of single-office banks is peculiarly liable to destructive panics. All the necessary evidence is to be found in the history of the 1907 panic in the United States.

When the difficulties of the Heinze-Morse chain of banks in New York City became public property, the individual depositors of the metropolitan banks, as well as their banking depositors, became somewhat uneasy about their balances. When the Knickerbocker Trust Company closed its doors on October 24th their uneasiness was changed to downright alarm. In New York City the individual depositors of those particular banks which were connected in some way with the Heinze-Morse group of financiers started a run which afterward spread to other institutions. The brunt of the battle fell upon the Trust Company of America, and upon the Lincoln Trust Company. It was recognized in the financial district of the city that a great deal depended upon the result of the runs on those two concerns. If they could be saved the storm would probably subside in a short while; if they closed, no one knew what might happen.

Cash Withdrawals of the Interior Banks

The individual depositors in New York City of the great clearing-house banks, and of other banks not involved or entangled with financiers who were under suspicion, did not become panic-stricken. Possibly some of them who remembered 1893 took prompt measures to withdraw their balances in the shape of cash, in the expectation that another suspension of payments would ensue, in the course of which cash would go to a "premium," as it did fourteen years before. But there were no runs on those institutions. So far as the disturbance in the city was concerned the plain duty of the Clearing-House Association was to lend cash support to the trust companies and banks that were beleaguered, or to such of them as were in sound condition. And it did not appear that that task was beyond their strength. Under a different system of banking they would, in all probability, have done this easily; the panic might have been stayed and the rest of the country saved much of its ill effects. But the clearing-house banks were not allowed to concentrate their attention and resources upon the spot in their defences at which the danger originated. Just at the time when to uphold the honor of the nation it was absolutely necessary for the banks to stand shoulder to shoulder, thousands of banks in the interior joined in a rush for the cash resources of New York, which should have been left available for fighting the panic in the city. It happened that the interior bankers, too, remembered 1893. They remembered how in that year the precious reserve money which they carried on deposit with great banks in New York was locked up beyond their reach, so far as cash withdrawals were concerned, through the suspension of payments. Even before the Knickerbocker failure they saw that events in New York were tending strongly toward another suspension; and in self-defence they proceeded to take the very action that made suspension inevitable.

Bankers' Balances in New York

Now let us look for a moment at the amount of the balances carried by other banks in the national banks of New York City on the eve of the 1907 panic. The last abstract of condition of national banks issued prior to the panic by the Comptroller of the Currency was that under date August 22, 1907. On that date the New York City national banks held, according to their reports to the Comptroller, deposits of other banks as follows:

Due to other national banks,	$259,255,782
Due to state and private banks and bankers,	79,072,395
Due to trust companies and savings-banks,	126,985,691
	$465,313,868

On the same date their holding of specie and legals amounted to $218,786,132. It is certain that a large proportion of the $465,313,868 of balances consisted of reserve money placed by the owners to be available against an emergency or evil day. It should be remembered that the amount merely represents the balances belonging to other banking institutions which the national banks of New York City held on August 22d.

Effects of the Withdrawals

Outside of the national banks are some large trust companies, state and private banks, each of which all the time carries heavy deposits belonging to the interior banks. But we may confine our attention to the national banks. It was remarked, a short distance back, that the interior bankers were manifesting a strong disposition to get their reserve money out of New York and into their own vaults at home. It was well known in New York that many of these banks would withdraw every dollar of their balances if they were allowed to do so. If, on the whole, the interior bankers withdrew in cash from the New York City

national banks only one-third of what they had the right to withdraw it would exhaust all the cash holdings of the New York bankers except some $66,000,000. If they set out to withdraw one-half their balances they would have exhausted the whole cash holdings before they accomplished their purpose, and would have left nothing at all in cash for the individual depositors of these same New York national banks, whose claims amounted on August 22d to $532,636,606. This makes it plain that had the demands of the interior bankers been complied with in full the available cash strength of the city would have been drawn away to the country or to the interior when it was urgently needed at the centre. In other words, it was as if some human body were desperately resisting the onset of a terrible disease. At the approach of the crisis, at the very moment when the heart required its full supply of nourishment, it was attempted to draw the life blood to the extremities.

The metropolitan bankers declare that the only means of stopping this huge drain was suspension of cash payments; whereunder the New York City banks refused to surrender the property of their banking and individual customers in the manner demanded, which was the manner required by law. Partly to save New York's face, and partly to prevent other difficulties and trouble, the order to suspend cash payments was sent to all the smaller financial centres. A large majority of them obeyed the order.

Panic of the Country Bankers

While the panic was in progress many of the country banks made frantic efforts to increase their reserves of cash in vault. These efforts were highly successful in quite a number of cases. Thus a bank in Indianapolis advertised that it had got its reserve up to about 60 per cent. of its liabilities, several in other places were above

50 per cent., and those which got above 30 and 40 per cent. were quite numerous. The point to be remembered is that at none of the points where these banks were located was there any run of depositors or alarm of any consequence. The piling up of cash was purely precautionary; each banker who undertook the task did so in order that he might feel safe and be prepared for a run if one developed.

Another thing to be noted and remembered is that many of the country bankers, in their haste to build up their cash holdings, were not satisfied merely to withdraw their balances from the central cities. Their course in doing that was destructive enough. It is understood that it forced the suspension of payments. The other measures they took were scarcely less destructive. They proceeded in a great number of cases to exact payment of all discounted paper as it matured, and refused to grant renewals or new loans. This is the thing that overthrew industry and trade, that forced worthy and solvent firms into bankruptcy, threw workingmen by thousands out of employment, and destroyed millions of dollars of the hard-earned profits of business men of all kinds.

Troubles of the Westinghouse Company

Everybody who follows financial happenings in the United States closely is familiar with the fate of the prosperous Westinghouse Company. It was doing a good business at the time of the panic, but it had outstanding an amount of short-date paper which was held in small lots by a considerable number of banks in different parts of the country. When the panic came these banks in almost every case demanded instant payment of the notes as they matured. As it was impossible during so troubled a time to negotiate new loans to take up the old notes, the Westinghouse people were thrown into bankruptcy. It is commonly said that their floating debt was

the cause of their failure. It would be fairer and more correct to say that they were the victims of an antiquated and inefficient banking system. It is not at all improper, and in countries other than the United States it is not unduly dangerous, for a great manufacturing concern such as the Westinghouse Company to have a reasonable amount of floating debt. Apparently the Westinghouse floating debt was not unreasonably large. Had it been all held by one or two strong branch banks, instead of being held by dozens of small bankers who had no interest in the company's well-being except in regard to the $10,000 or $25,000 worth of notes which they held, the company probably would not have been embarrassed by the New York panic—for their bankers would have recognized it as a duty to carry them along; and, even if the company were in fact insolvent, the bankers might very likely have carried it till the excitement and panic had subsided.

The Westinghouse case is typical of many others. Manufacturers large and small, who depended upon credits got through the note brokers from scores of little banks which operated far from the localities in which the factories were situated, were forced to curtail their operations, and were considerably embarrassed as a result of the attitude of the interior bankers who pursued the policy just referred to. Some of them were, like the Westinghouse Company, forced into insolvency, when if they had been able to get the banking support to which their financial position and their worthiness entitled them, and which the banks in other countries accord to their customers in panics as well as in ordinary times, they would not have been seriously troubled.

Interior Bankers Not Altogether to Blame

During the last two months of 1907, and in the early part of 1908, the interior bankers were lectured rather severely for their hoarding propensities. It was ex-

plained to them that their conduct was unpatriotic, and they were told that it was their duty to put their cash into circulation rather than to store it in their vaults. But when all the circumstances are considered it will be seen that much unmerited blame was then laid upon the bankers of the interior. The country banker is not at all to be blamed if he takes instant action to recall his New York balance in the shape of cash when he anticipates that an embargo is about to be laid upon it. It is all very well to talk to him about the duty of the banks to stand shoulder to shoulder and to support each other, but he knows well enough that when it comes to meeting a demand of his depositors for cash he will have to stand on his own legs. No, the censure for the hoarding of cash by the interior banks should not be laid upon the interior bankers. It belongs by right to the system of banking.

Carrying Cash Reserves in New York City

No matter what system of banking exists in the United States it will always happen that each individual banking office will be called upon, in the ordinary course of its business from day to day, to meet a certain proportion of the withdrawals by its depositors through providing drafts or orders upon New York, Chicago, St. Louis, or another centre. It will be required, also, to provide the proceeds of a large proportion of the loans and discounts, put through for its borrowing customers, in the shape of drafts upon these same centres. This is so because the bank's customers, depositing and borrowing, have to make a large share of their payments in those centres. Therefore, as the demands upon the bank's resources converge largely upon New York, it is more or less essential that it shall carry a large proportion of its cash reserve in that city. But—and here is the weakness of the existing banking system in this respect of reserves—it cannot have its reserve in New York City

and at the same time retain possession of the cash itself. In order to enjoy the advantage of having its reserve at the desired strategic point, it must surrender the cash to other hands, and rest content with an undertaking by another bank to return the funds as demanded. This difficulty will never be obviated as long as each bank has but the single office. It vanishes entirely with the introduction of the branch system and the establishment by each important bank of a branch or agency in New York City. Then the reserve may be kept at the centre where converge the demands upon it, and it may at the same time remain in the possession of the bank that owns it. There need be no haste to withdraw it to the country places where there is no run or no great immediate danger. The country branches may rest easy with the knowledge that their cash reserve is in New York in the vaults of their own bank under the charge of their own officers.

How Branch Banks Would Handle a Panic

To make this picture more complete and the contrast more striking it will be well to describe how a system of good branch banks would deal with a panic. Perhaps I shall be forgiven if I refer to Canada again and relate how the branch banks there actually did deal with the 1907 panic.

There were eminent bankers in New York, Chicago, and other American cities who early in 1907 endeavored earnestly to induce the general body of bankers throughout the United States to prepare for a storm. Owing to their advantageous viewpoint, their experience, and their knowledge of banking, they clearly foresaw that a crisis was on the way, though they could not, of course, know when it would materialize. They accordingly put their own houses in order and did what they could to get their neighbors to do likewise. However, they had no authority over the thousands of other bankers who saw

nothing but the sun of prosperity and who were intent upon making the last dollar of profit while the high interest rates continued.

POLICY OF THE CANADIAN BANKERS

Now the experienced professionals who had charge of the important Canadian banks were not behind the great bankers of the United States in diagnosing the situation as dangerous. They, too, saw that exceedingly dirty weather was ahead. They were, however, situated much more fortunately for dealing with the matter than were their brethern in New York and Chicago. The latter could only make guarded statements and issue guarded warnings, which, as a matter of fact, were not heeded by a large number of bankers. But the Canadian bankers had the power to impose their will upon all the banking offices in the Dominion. For nearly a year before the panic developed business men and firms asking for largely increased credits were told that they must keep their lines down and go slowly. A great many were thus prevented from spreading heavy additional sail at a dangerous time. Then, four full months before the panic broke, a quiet but effective movement of liquidation of discounts was instituted. In July, August, and September, notwithstanding that those months ordinarily witness an important expansion of domestic loans, the mercantile discounts were cut down. As may be supposed, this policy of repression and liquidation brought the bankers much unpopularity. Loud were the complaints and accusations that were levelled against them. They were told that they were retarding the development of their own country. People pointed to the call loans in New York (part of their reserve money) and declared that the Canadian banks were starving Canadian enterprise in order to lend money to Wall Street speculators. Before many months had passed those merchants and others

who had resented most bitterly the enforced curtailment had reason to be thankful that they had been held in check. When the panic burst and their outside creditors began to press them hard for settlements, and when it was difficult to buy goods abroad except for cash, they had to acknowledge that they were fortunate in having their bank lines well in hand and their debts moderate in amount.

Advantages of Concentration of Control

It was not so easy then as it now is to see that a policy such as that pursued by the Montreal and Toronto bankers was exactly the right preparation for the panic. It ensured that when the storm came Canada was running under reduced sail. And to that happy circumstance is to be ascribed the ease with which she surmounted the crisis. It should be quite clear that such intelligent and effective preparation for a panic is only possible where the branch system prevails, for it is only through the exercise of their control over the branch managers that the professional executives are able to force industry and trade into an attitude of preparedness.

Then, mark the advantage enjoyed by the Montreal and Toronto bankers after the panic breaks—when the actual fighting begins. It has been remarked that while the attack centred at New York City, the efforts at resistance made by the New York bankers were largely neutralized, and they were eventually forced into a suspension, by the drain of cash to points in the interior where no runs existed, and where, as it turned out in the end, the cash was not needed. This drain the New York bankers were powerless, legally, to prevent. Very different was the case of their Canadian confrères. The available cash strength of the respective banks (apart from the balances and call loans carried abroad) was concentrated at the centres—chiefly at Montreal, Toronto,

and Winnipeg. Suppose some scores or some hundreds of the branch managers fell into a panic and wired the head offices to send thousands or millions of dollars in cash at once, it would not matter in the least, since the general managers would not send their cash to points where it was not needed. The panic-stricken managers would be told to keep cool and to proceed with their business as usual. The cash resources under the branch system can be kept in reserve at the strategic centres, and they thus preserve their force unimpaired. The general in command has his forces well in hand; he also has full intelligence of and a clear view over the field of war; and he hurries support wherever it is needed. The United States position is as if a general had assembled a large army to meet an adversary of equal or greater strength, but on the eve of battle he is required to send away half or two-thirds of his whole force, in a hundred small detachments, for the purpose of garrisoning a hundred towns not threatened at all by the enemy. It is not to be wondered at that he meets disaster in every great struggle.

The Question of Future Panics

Some authorities on finance have been assuring the public that the panic of 1907 and the events that followed it eliminated the element of danger from United States banking. They say that the lesson was taken to heart by the banking interests, that reforms have been effected, and remedial legislation passed, and that henceforth the business will be cleaner and sounder and no more panics need be feared for many years. It would be well if these comfortable assurances could be relied upon. To govern one's conduct upon the assumption that they are well founded might prove exceedingly dangerous. In the last published abstract of condition of national banks—that for September 1, 1910—the New York City national

banks are given as holding deposits of other banks as follows:

Other national banks,	$315,010,697
State banks and private banks and bankers,	94,353,403
Trust companies and savings-banks,	208,692,447
	$618,056,547

Their holding of specie and legals at the same time was $291,652,553. Thus there has been, since the pre-panic statement of August 22, 1907, an increase of $152,742,679 in this dangerous liability; and the proportion of the cash holding to the total of bankers' deposits is about 49 per cent., as against 47 per cent. in August, 1907. There is no reason to suppose that when next something happens to scare them badly the interior bankers will act differently from the way they acted in 1907. Whenever they see the situation in New York getting palpably out of the control of the banking interests there they will very likely rush for their balances, just as they did in previous panic years.

Bank-notes as a Medium for Paying Off Depositors

It is but fair to say that since the panic of 1907 Congress has enacted legislation designed to enable the banks, both metropolitan and interior, to cope more advantageously with the panics of the future. In reciting the several advantages enjoyed by the Canadian banks, in regard to dealing with panics, nothing was said about one important item. Wherever a panic of depositors occurs there is urgent need of a medium, for making payments, which will be safe and entirely acceptable to the frightened creditors, and yet consist of something other than specie or legals. Such a medium the Canadian banks possess in their note issues. The notes of each bank are covered by what is practically a mutual guarantee of the associated banks of Canada. As there will be a chapter devoted exclusively to the matter of the bank note issues, it will

not be necessary here to dilate upon the features of the plan further than to say that the important banks consented to go into that scheme, whereby their stockholders were made liable for the note issues of all other chartered banks in the Dominion, because the issue of each bank was strictly limited to the amount of its paid-up capital, and because the notes in every case were to be an absolute first lien on the assets of the bank issuing them. Afterward the Canadian Bankers' Association obtained the right to inspect the circulation books of each bank, as a measure of protection for the associated institutions against illegal over-circulation by the several members. And finally, in 1908, the Dominion Parliament conferred on the banks the right to issue an excess circulation during the crop-moving season. Under this law each chartered bank may, between September 30th and the 31st of the following January, issue an additional amount of its own notes equal to 15 per cent. of its combined capital and surplus. The ordinary issue (up to the paid-up capital) is free of tax and interest; the excess issue is subject to a rate of interest to be fixed by the Minister of Finance, which, however, may not exceed 5 per cent. per annum. Finally the Bank Act subjects the outstanding notes of an insolvent or suspended bank to interest at 5 per cent. per annum, to run from the date of suspension to the date on which the liquidator or receiver advertises his readiness to redeem them. Owing to these conditions and provisions, in every case of failure of a chartered bank in Canada since 1890 the notes of the insolvent institution have circulated freely at par in equal credit with the notes of the going banks until the liquidator has succeeded in effecting their complete redemption.

The National Currency Associations

Now it will be understood that if there were a run of depositors upon a Canadian bank, the depositors, or at

any rate all of them who possessed average intelligence, would be quite willing to accept its notes in lieu of their deposit claims. So, during the early stages of a run it would have a convenient means of meeting withdrawals. If, however, its circulation was nearly up to the authorized limit at the time of the commencement of the run—and some of the smaller banks are in that condition through nearly the whole year—it would get hardly any relief of this kind from its own rights of issue; but other larger banks possessing an ample margin of issue rights might lend it assistance in the shape of their notes, and in that way a run or runs might be met by expansion of the general note circulation until the issues of the banks generally were brought close to the authorized limits.

It is apparent that the object of the Vreeland Bill, passed by Congress immediately after the 1907 panic, is to provide for the national banks of the United States a medium of this nature, for use in a panic or emergency, which will economize specie and legals and yet give the alarmed depositors something that will be entirely acceptable to them. Briefly put, the legislation permits any number of national banks, not less than ten, located conveniently in any city, state, or contiguous territory, to form a national currency association. To be eligible for membership therein a bank must have outstanding not less than 40 per cent. of its capital in United States bond-secured circulation, and it must have a surplus of not less than 20 per cent. of its capital. When the association is formed, each member may, in an emergency, pledge commercial paper with the association and apply to the board of the local association for notes. If the securities are satisfactory the application is forwarded to the Comptroller of the Currency, who in turn transmits it to the Secretary of the Treasury, and if the Secretary considers that business conditions in that locality demand it, and is satisfied with the character and value of the securities deposited, and that the United States has a lien on the

securities deposited and on the assets of the banks composing the association amply sufficient for protection, he may direct the issue of the currency to an amount in his discretion not exceeding 75 per cent. of the cash value of the securities deposited by the bank with the association. The amount of currency thus allotted to any bank must not exceed the margin between its outstanding ordinary bond-secured circulation and its combined capital and surplus; that is to say, the ordinary bond-secured circulation plus the emergency circulation may not exceed the capital plus surplus.

Emergency Note Issues Against Deposits of Bonds

Or, if it does not wish to join a currency association, the bank may deposit state, city, town, or county bonds, and apply for notes up to 90 per cent. of the value of the bonds, but not more than the par value of the bonds. In this case the bonds are to be deposited with the Treasurer or any Assistant Treasurer of the United States, and application is to be made to the Comptroller of the Currency.

With the object of ensuring the prompt retirement of the notes after the emergency has passed it is provided that the emergency notes are to be taxed at the rate of 5 per cent. per annum for the first month, and afterward at a rate rising 1 per cent. each month until the maximum of 10 per cent. is reached.

It is possible that this measure may furnish the means whereby the New York bankers will be enabled to meet successfully a stampede of interior banks for their balances. Those who designed it expect that it will provide a satisfactory medium for meeting runs. At the same time the banks have shown little inclination to form currency associations in order to have the machinery in readiness for dealing with an emergency. The measure has been criticised considerably by the banking interests. One objection is that the method by which the emergency

notes are to become available is complicated, and that the applications must pass through several hands before the party is reached who has the power to act. It is objected again that the tax is so high as to deprive the issuing banks of practically all profit upon the notes, thus destroying the incentive to issue and making it probable that only those banks which are in desperate circumstances will resort to the remedy. Until the measure has been tried out in actual practice it is impossible to estimate what its effects will be. If it fails to fulfil the expectations of its authors, and the national banks do not apply for emergency notes, or if they are slow in doing so, it seems probable that another suspension of payments will be seen the first time the interior bankers lose their heads.

How the Reform Will Work

Suppose the law does what is expected of it, and that in the next crisis the national banks have recourse to its provisions in such numbers and to such an extent as to avert a general suspension. That would mean the creation of a very considerable volume of the emergency notes. They can only be created through pledge of the assets of the banks issuing them. Suppose $300,000,000 were created. If the security consisted entirely of commercial paper it would mean the sequestration of $400,000,000 of assets which formerly were free. If the new notes should be used to pay off depositors it would mean that the banks had temporarily parted with $400,000,000 of their assets in order to borrow $300,000,000 with which to pay off their depositors. The position of the remaining depositors would be weakened to that extent. This borrowed money must be repaid before the assets can be regained. The repayment can be effected without distress only if the individual banks succeed in inducing their depositors to redeposit practically all of the funds withdrawn. On the other hand, it might happen that a

considerable number of banks would apply for emergency notes with the object of paying off debts due by them to other banks; some might do so with the object of getting funds to make new loans to their customers, or to protect deals or speculations of their own officers or directors. To the extent that this was done it would mean that securities formerly held generally against the deposits and liabilities were placed beyond the reach of the ordinary creditors. It should be remembered, too, that the assets pledged, whether bonds or commercial paper, would be, in all probability, the best in the portfolios.

Payment in the Bank's Own Notes Gives Only Temporary Relief

It is to be remarked that the same objection applies to the use by the Canadian banks of an expansion of their note issues to meet runs of depositors. In Canada's case, supposing the bank which is run upon goes down after expanding its issues to the limit, it means that a few of its depositors who were fortunate enough to convert their balances into bank notes escape without loss. But their success makes the remainder of the depositors worse off, since it has created a larger amount of preferred claims which must be liquidated before the ordinary creditors may participate in the estate. It is also to be borne in mind that the Canadian bank, which during a run pays by means of its own notes, does not thereby conserve its specie and legals except for one or two days; for the depositor will at once pay the notes into one or other of the stronger banks, and the beleaguered institution will receive them back promptly, along with other of its obligations, through the clearing-house; and it will be called upon to redeem them with legals forthwith.

Banks Should Support Their Customers in a Panic

Possibly the foregoing descriptions and illustrations will have served to explain what a vast difference there

would be in the handling of panics in the United States if the banking system of the country consisted altogether, or nearly altogether, of large and strong branch banks. In the first place, it would be possible to do something worth while in the way of preparing to meet the panic. With experienced professionals in charge, and endowed with the authority requisite for compelling obedience to their orders, the ship of finance could be gotten into trim for encountering a tempest some little while before the wind and waves burst upon it. The mercantile and manufacturing interests which depended on bank loans for carrying along their operations might be held in restraint for a while before the panic developed; and after it broke they would be supported and carried. The cash resources would not be sent to lie idly in vaults at Indianapolis or Salt Lake City when New York was the place where they were needed. The country bankers would not be so apt to lose their heads; for one reason, because they would be all trained men, and, for another, because the responsibility of maintaining the solvency of the banking offices under their charge would lie not upon them but upon the executives at the head offices. There would be a more general knowledge among the whole fraternity of the fact that the surest way for a bank to hold the confidence of its depositors during a panic is for it to continue making advances to its customers. Wherever banking is regarded as a science it has long been understood that a policy of frantically calling in loans, refusing renewals of matured paper, and refusing to extend the customary support to regular borrowers is exactly the policy calculated to start a run of depositors.

IV

THE CLERKS AND OFFICERS

Conditions of Service

IT will be advisable now to refer to the conditions of service. When the merits and demerits of a particular system of banking are under discussion it is important to have a satisfactory knowledge of what it does for its devotees. How do the men fare? Those devoting their lives to the service of the local independent banks of the United States—are they better or worse off than their fellows serving under different systems in other countries? Are the rewards for faithful and intelligent work large enough and sure enough to attract the best men into the business? Or is the banking service studiously avoided by intelligent youths able to choose their means of earning a livelihood and not bound by family or other ties to certain avocations?

By getting answers to these questions one may learn a great deal as to whether the usefulness of the banks could be increased. It will be clear to every intelligent mind that a system under which the men are hopeful, keen, and zealous will in its daily working, other things being equal, forward the country's commerce and industry immeasurably better than another which provides only a monotonous and dreary future for the employees to gaze into.

A Forecast of Branch Banks

Immediately after the panic of 1907, when the banking breakdown caused a large number of the experts to in-

terest themselves in the question of the desirability of instituting branch banks in the United States, an ardent supporter of the existing system argued that bank employees should fight tooth and nail against the branch idea because its adoption would be detrimental to their interests.

"If the large number of interior banks now working independently were converted into branches of great institutions having head offices in New York, Chicago, or some other centre, and were under the management of far-away executives intent upon economical administration and operation," so ran the argument, "thousands of men would be dismissed in every part of the country; and so the profits of the stockholders would be built up through taking the bread from the mouths of an army of bank men."

An Economic Revolution

Even if this forecast of what would happen to the employees were correct, it could yet be made into a powerful argument not against branch banks but for them. It implies that the banking business at present is wastefully conducted in that it is supporting a host of unnecessary officers and men. Waste of this kind constitutes a tax reaching in some way citizens of almost every class. Waste in banking tends to increase the rates of discount which commercial and other borrowers must pay, to restrict the amount of credits available for their use, and to decrease the interest rate on deposits, while at the same time making the depositors' position less secure. Though an economic revolution, wherein a mass of labor is displaced through the introduction of improved machinery, commonly causes temporary hardship, it is considered that the benefit accruing to the whole public through the cheapening of a much-used article outweighs the injury done to the particular class. In America especially is this doctrine recognized, and it is commonly understood

that much of the progress of the nineteenth and twentieth centuries has been achieved in this way. The mistake made by those who use such an argument against branch banks is in assuming that the bank stockholders would get all the benefit of the economies. Experience teaches that although those owners or proprietors who first introduce labor-saving machinery often benefit considerably in their profits, in the long run competition ensures that a large share of the gain will go to the consuming classes.

Thus it can be seen that if the institution of branch banks resulted in some thousands of unnecessary bank employees losing their places, a substantial compensation would very likely accrue, in the end, to the people in general as a result of the change. In other words, it might be expected to represent, according to this theory, the sacrifice of a certain class, not very strong in numbers, to the general good.

But what if it should develop that the economies and benefits of branch banking could be given to the people of the United States without inflicting any hardships at all on the bank employee? What if the innovation, instead of injuring him, should result in a decided bettering of his circumstances? What if it opened for him an attractive prospect of which at present he knows nothing at all? If it can be shown that branch banks would so affect the rank and file of bank men the illustration should constitute a potent argument for their introduction. Let us therefore now inquire into the conditions of service presently prevailing under the existing system of local banks.

Service in Wall Street Banks

It is well understood that the best prizes which banking has to offer lie in the great cities. New York itself, being the financial heart of the nation, has in its gift the most valuable of them all. To win the place of president or vice-president of a great metropolitan bank is a high

and enviable achievement. Some of the men now holding those positions worked up to them without extraneous aid, by sheer ability and industry. Theoretically the achievement may be performed by any person entering the service. But in practice, under the present system, a large number of the really good men, perhaps the majority of them, have no hope whatever of rising to the high places. Take a large Wall Street bank employing two hundred or three hundred men. At the top are perhaps a dozen places carrying very large salaries. The incumbents of those positions hold them indefinitely year after year. Nothing except the death or resignation of some one higher up provides the opportunity for promotion. Down through the various grades and departments the same condition prevails to a greater or less extent. It may be said that there is no satisfactory circulation of the men. In some banks there is a system whereby the men are shifted from one post to another as a guard against fraud, but a movement of that kind is not at all to be compared with the rapid, irresistible movement by which the best men in the Canadian branch banks find themselves placed, after service for a certain number of years, in high and commanding positions. In a great New York bank three or four, or perhaps half a dozen, out of every hundred employees may hope to rise to positions of real importance. The rest have scarcely any chance. One way there is in which a moderately rapid promotion might be ensured. The policy might be followed of casting aside the men who arrive at or pass middle age without rising above the purely clerical work. However, not many bankers could bring themselves to employ so hard-hearted a plan of improving the tone of their offices.

A Dreary Outlook

Thus it happens that all that the bulk of the employees can look forward to is steady employment at salaries

which may rise slowly or not at all. Day after day, year after year, they answer the roll-call, growing old and gray-headed, always at the same work. As for the few who do climb high their progress is impeded because of the places found and promotions fixed for relatives and protégés of the highest officers and the directors. It must be conceded that such an outlook as this is exceedingly dreary, not at all calculated to inspire enthusiastic service or to draw the best material into the service of the banks.

Such are some of the conditions in the largest cities where the best opportunities are to be met. As may be supposed, conditions in the smaller places in some respects are worse. In them, practically everywhere, there is a positive block at the teller's post. Beyond it one may not hope to rise for years and years, except by a lucky chance. Above the teller are ranked the cashier, vice-president, and president. Twenty years may pass without a single change occurring in those offices. True, the business may grow, more clerks may be taken on and put beneath one, so to speak, and the salary may go slowly up, but the high positions are not thereby brought nearer. There is sadness as well as humor in the popular saying that the bank clerk in the country town passes the most of his life looking out of the same window at the same town pump.

Conditions of Service in Canada

In the Dominion men are not hired, as a rule, to fill any post that happens to become vacant. Nearly all the employees are taken on as juniors, preferably at the age of seventeen or thereabouts, with salary of two hundred or two hundred and fifty dollars a year. When a new and responsible position is created, such as by opening a new branch, or when a vacancy occurs in an existing position, likely as not a whole line of promotions

affecting even the junior clerks will take place. As for the junior, the bank does not hire him with the design merely of developing him into a good clerk; its real object is to make an expert banker out of him, to develop his judgment and his knowledge of banking principles to such an extent that he can be trusted to take charge of the bank's affairs at important branches, and as its representative to deal with the leading business men and depositors, to dispense credits and gather them in again, to act, in short, as responsible agent for administering a fund which might amount to several millions of dollars. In every junior taken on its staff the bank hopes to find material that will develop into a servant of this kind. Its system of training is shaped with the object of discovering and encouraging every man who has promise or ability.

Every Man Has His Chance

At the annual salary revisions the young banker may expect, in regular course, increases of one hundred dollars per year. In addition he may get special increases for specially good work, or to accompany his promotion to a higher post. He will proceed after this manner until he is in the neighborhood of eight hundred or nine hundred a year, when he reaches what may be regarded as the crisis of his career. It may take seven years or more to demonstrate whether he is available for the more responsible posts, or whether he is fit for nothing but clerical work. So great is the pressure for men to fill positions as managers and accountants of new branches that the executives will often give the proved incapables another chance, in the hope that they will make good; and it is with the greatest reluctance that they are abandoned to their permanent clerkships. Even when they are so abandoned they doubtless will get, if their conduct is good, increases of fifty dollars, or perhaps a hundred, at uncertain intervals.

Openings for Men with Ability

But, as regards the young banker of eight or ten years' service who has demonstrated that he has good average ability, it may be said that he is just on the threshold of his real advancement. Before he is thirty he may get an appointment as manager of a new branch, and then his future is just what he makes it. A great many of the new branches are established in small Western towns where the business grows rapidly. An office may start with a manager and one clerk and develop in a few years into an important branch with six or seven clerks and half a million in discounts. If the manager accomplished this without making losses through bad debts he would get quick increase of salary and the head office would certainly have him in mind when the post of manager in a large city next fell vacant. It is not at all unreasonable for a junior to expect that in fifteen years from the commencement of his service he will become manager of a good office and be drawing a salary of from $2,000 to $4,000 a year. As an example of the prospects in the banking service in Canada the case of one branch in which I myself served might be quoted. On my joining the branch the staff consisted of a manager, an accountant, and ten clerks. Two of the clerks resigned—one to take a very good position in an insurance office, the other because of dissatisfaction at his progress. Within twelve years the manager had gone on the pension list and every one of the others had become branch managers at salaries ranging from $1,200 to $4,000. Two, who were juniors in 1893, now command the bank's branches in two of the most progressive of the far Western cities. Not one of these young men considers that he has reached his limit; practically all of them believe, and with reason, that their progress has just begun.

Promotion Free and Unrestricted

So far as the figures of the salaries are concerned, it is, of course, to be borne in mind that Canada is a poor country as compared with the United States; and on that ground alone one might expect a smaller rate of pay to prevail north of the international boundary. It would be easy to quote examples in the Dominion of advancement more rapid than this. The principal cause of the quick promotion and rapid increase of salary has been the branch bank extension movement. That did not attain great velocity until after 1900. Therefore, the example I have given contains at least seven years in which conditions were not so favorable as at present.

The point which I wish to make by means of the illustration is that every member of the branch staff had the opportunity of rising to a managership; all but two of them actually did so. In the Canadian system there is no block anywhere, neither at the teller's nor at any other post. Promotion is free and unrestricted.

From these two sketches it is possible to get a fair idea as to the contrast between the two services—that of the United States and of Canada. As before mentioned, it is not denied that extraordinary ability may win great prizes in the Republic; but it is contended that the general body of bank employees in the United States have a poor chance as compared with that possessed by all Canadian bank clerks. In the Dominion no gray-headed men are found in subordinate positions unless from some fault or shortcoming of their own or from exceptionally hard luck. In the path of promotion there is no barricade or block from the junior's post up to that of the general manager.

Branch-Bank Service Provides a Better Education

Another thing to be borne in mind is that the conditions of the banking service in Canada are such as to give

the employees a better all-round knowledge of banking than is possessed by the bank employees in the United States. The Canadian bankers are all trained men, while many of the American bankers are not. Dr. Joseph French Johnson, dean of the School of Commerce and Finance of New York University, in an address to the Missouri Bankers' Association in May, 1909, on his return from a visit to Canada, had the following to say regarding this matter of the qualifications of the bankers: "I discovered in Canada what seemed to me to be the beginning of a profession for bankers. It ought to be a profession. It ought to rank with the learned professions. It is as much a profession as law, medicine, or engineering. We don't find it so much of a profession in the United States, I am sorry to say, as I found it in Canada. If I wanted to be a bank president in the United States, or if I had made up my mind to be in youth, I would not have studied the banking business, knowing what I do now. I would not have gone in as a clerk in order that I might become paying teller, cashier, and vice-president. I never would have gone through by that route. No, I would have gone into business — the manufacturing business, wholesale business, any kind of a business in which I could make money and buy some stock and elect myself bank president. I do not know that you do that way here in Missouri, but it is done that way a great deal in the United States. Nothing of the sort do you find in Canada."

Why the Branch System Is More Attractive

It is hardly possible to ascribe the difference in conditions existing on the two sides of the boundary line to anything else than the difference in the two systems of banking. The service in Canada is more attractive because the branch system is in vogue there. Constant additions of new branches to the various banking organizations results in creating numerous opportunities for pro-

motions. Besides the changes necessary to fill those positions, the steady increase in the number of bank branches tends to create, all the time, new positions of importance in the executive offices. As the branches multiply the number of officers engaged in supervising and controlling them must be increased, and the positions of the existing officers constituting the executive force must get more important.

But a comparison such as the foregoing cannot be taken as an entirely satisfactory illustration of what American bank clerks would gain from the institution in the United States of branch banks of the Canadian type. Every youth of really good ability who enters the Canadian service as a junior may feel tolerably sure that his ability will be discovered, and that he may, provided he attends earnestly to his duties, governs his conduct properly, and retains good health, rise to be manager at some such place as Hamilton, Ottawa, Winnipeg, Vancouver, or Quebec, or it may be Montreal or Toronto. With the same banking system in vogue in the United States, every American youth of real ability entering the banking business and giving the same attention to his duties and conduct would have an equal opportunity of rising to the managership of branches far more important than are to be found in the Canadian cities.

The Service of a Great American Branch Bank

The dignified, highly paid posts open to him would be numerous and varied. The service of a great American bank with branches everywhere in the Union would be alive with brilliant possibilities for ambitious minds. Employed on its staff there would be no danger whatever of being doomed to gaze for a lifetime at the same town pump; no danger of being kept down because the teller, the cashier, the president, and vice-president were more or less permanent fixtures. The work would be vastly

more interesting. In twenty or twenty-five years a man might see service in half a dozen different states. Such an experience could hardly fail to broaden his mind and increase his knowledge of his own country.

Another way in which the bank clerk would gain through the general introduction of the branch system would be in the improvement of his social status. An employee of a powerful bank possessing hundreds of millions in assets, carrying the accounts of great corporations and capitalists, and having branches scattered widely through the country would be a more important unit in the social world than the employee of the typical single-office local bank. The prestige of the institution he served and the possibility of his rising high in its service would cause society to rate him better than it now rates bank clerks in general.

Branch Banks Would Increase the Demand for Men

But it is time to deal with another matter. In the earlier part of this chapter notice was taken of the argument that thousands of bank men would lose their places if branch banks were introduced. Let us see what would likely happen in this regard. If branch banks are ever introduced, the introduction will almost inevitably take place through the conversion of thousands of independent interior banks into branches of larger institutions. Whenever one of these absorptions occurred the staff of the acquired bank would be retained, because it would be in the interest of the consolidation to retain the men. In all probability the cashier would become manager of the branch. But the presidency, the vice-presidency, and the local board would be abolished. So far as the clerks are concerned there is no hardship involved in that. After the branch movement got well under way it is very certain, if the Canadian experience goes for anything, that an active campaign of opening branches

in altogether new places would be instituted. Hundreds of places that now have no banking facilities at all would be supplied with offices designed to carry on the business of discount and deposit. That would come about because a branch with simply a manager and one or two clerks can be operated at a profit on a less volume of business than would be necessary for an independent bank with full paraphernalia of officers and board. For the new branches managers and accountants would be wanted. The banks would find it more advantageous in the long run to promote their own men to the managerships than to take in outsiders about whom they knew little or nothing. Hence the practice of taking in juniors and training them would naturally be evolved.

There is, therefore, every reason to expect that the institution of branch banks in the United States would be followed in a short while, if the banks were of the right type and were given reasonable privileges and a reasonable degree of freedom, by a remarkable expansion in the demand for men. It would follow necessarily that salaries would be moved generally above the present level.

How the Officers Would Fare

Next, let us see how the officers would fare upon the introduction of branch banks:

It was remarked that on the absorption of an independent interior bank into a branch institution the offices of president, vice-president, and board of the absorbed bank would be abolished. In actual practice, when this occurred, the executive of the absorbing institution would take pains to discover what officer or officers had conducted the active management of the absorbed bank while it had an independent existence. It might have been the president that had had the active management; it might have been the vice-president; or it might have been the cashier. Whichever one it was

would be taken into the service. If more than one of the governing officers could properly lay claim to be considered a professional banker, the bank would doubtless desire to retain them. The only officers for whom it would have little or no use would be those who were actively engaged in some other business or calling, but who exercised the right of supervision or control over the local bank's business in the interests of the stockholders. Obviously the new system would contain no places for them. Internal supervision and control, in the case of a branch bank, are exercised from the head office by a skilled professional assisted by a corps of expert examiners.

The Cashier's Opportunity Would Be Enlarged

But the position of the cashier, or other officer who has had in his hands the active management, becomes in some important respects considerably improved when the bank is converted into a branch under his management. Under the system of local banks he has to operate the bank subject to the supervision and control of the local directors. In most cases they are men engaged in some outside business. Usually they are men of substance and influence. Their attitude toward their cashier may be one thing or it may be another. One board may leave its cashier practically untrammelled in his conduct of the bank's affairs, contenting itself with loosely supervising the loans and other business. Another board may contain one or more domineering characters, who, without any real understanding of banking, insist upon constantly interfering in the active management. They may cause the cashier to take paper of which he disapproves; and they may find fault with certain of his advances, desirable and right from the strictly banking point of view, but to which they are averse because of local prejudice or sectionalism. There must be in the United States many capable cashiers or managers who feel themselves thwarted

at every turn by these meddling incapables. From all that, absorption into the branch system offers a complete and immediate deliverance. Acting as a local manager of a branch bank the American country banker would be delivered from the domination of the local magnate. His obedience is claimed instead by an expert who knows a great deal more than he of the business of banking. This expert knows little or nothing of the petty politics of the country town. He probably will insist that the bank be not involved with any of the local parties or cliques; that applications and requests for credits be judged solely on their merits as banking propositions.

Increase of Responsibility and of Salary

As a branch manager the country banker will have a local standing quite as high as, and probably higher than, his standing as the active head of a single-office bank. Though the branch manager's power to grant credits is strictly limited—he having to get the chief executive's approval for all loans exceeding a certain sum, which might be anywhere from $1,000 to $2,000—he yet is the man through whom all would-be borrowers must negotiate. The general manager will not consider propositions which do not come to him stamped with the branch manager's approval. A competent and careful manager soon gets to know exactly what loans will go through and what will not, and he can thus say "yes" and "no" to most of his customers who ask for credits and demand an immediate answer. As the highest resident authority of a great bank, the channel whence its many millions of resources are placed at the disposal of the local business men, he will likely stand higher than as cashier of a small local bank which, by common repute, did not have the funds at times to give its customers all the credits they required and to which their positions and responsibilities fairly entitled them.

In point of salary the banker might reasonably expect a larger remuneration on the conversion of his independent bank into a branch; for, as explained in another chapter, the business of the bank would be likely to expand rapidly after the change. With the increase of business increased pay should, and doubtless would, be forthcoming.

The change would deliver the country banker from a number of other restrictions and duties. Under the present system he has to give a good deal of thought to the matter of the maintenance and disposition of the bank's cash reserve; under the branch system he need not worry about the reserve at all, for the general manager himself attends to that. He need not bother himself either over the investment of the bank's money in bonds, for the general manager does that also.

V

A HYPOTHETICAL BRANCH BANK

How the Banks Perform Their Functions in Normal Times

IT is time now to take up the matter of the every-day relations between the banks and the other parties in the community. Panics come only at intervals. Even in the United States, where they are most frequent, they have not hitherto appeared oftener than once in a decade. Though it is a matter of importance in any country that the banking system be so constructed as to be able to withstand successfully the shocks resulting from periodical revulsions of credit, it is a matter of much greater consequence that it be of a character calculated to lend in the between whiles an efficient and thorough encouragement, within certain limits, to all the forms of industry and trade in which the people of the country are engaged. So I shall now proceed to point out how certain great American industries and trades fare at the hands of the banks in normal times, from day to day and from year to year. Their circumstances may then be compared with the circumstances of similar industries and trades elsewhere under the branch system of banking. By placing the two pictures side by side any reader may get a vivid impression as to some of the differences, in economic effects, of the two kinds of banking.

The Matter of Equality of Loans and Deposits

The true function of the banks in any locality is to facilitate and assist, within certain limits, the carrying

on of those pursuits to which the people are devoted. They reach their highest excellence and their greatest usefulness when they conform flexibly, in the several sections, to the peculiarities of condition or circumstance which they meet. This is exactly what a properly constituted system of branch banks does; and, though the local single-office banks may indeed conform in certain respects to local peculiarities of occupation or trade, they are not constituted to cope advantageously with the matter of inequality of loans and deposits. It is, of course, absurd to suppose that at all the banking points in the United States loans and deposits should be exactly equal; and yet that is, apparently, one of the things on which the system of single-office banks is predicated. The experience of the large Canadian banks, with branches in every part of the Dominion, is that in only a small number of instances do the branches show equality of loans and deposits. In the great majority of cases one will overbalance the other. Usually it is found that the branches in the farming districts of the eastern provinces show an excess of deposits, while the branches in the eastern cities and manufacturing towns, and the general run of country branches in the western provinces, show an excess of loans and discounts. This is the result of encouraging the development of both loans and deposits to the fullest possible extent at all localities. In other words, at practically all points both loans and deposits are at the natural level.

What the Banks Can Lend

On the other hand, the merest tyro in banking can easily see that, at every point, the local single-office bank must shape its policy, in regard to loans, according to the amount of deposits it has. In this sense the comparison as to the usefulness to the locality of the two kinds of banks may be made by means of a formula—thus, each single-office bank has available for lending in

its locality its capital and surplus plus deposits minus its reserve against deposits, while the branch bank may be said to have a sum equal to the effective natural demand for discounts emanating from that locality. The term effective demand is here taken to mean the demand from parties financially and otherwise worthy to have recognition.

Critically minded persons will perhaps object that there is a limit to the lending power of a branch bank as well as to that of a local bank, and that there would be no certainty that on the general institution of branch banks the effective demand for credits would be cared for at each particular point any more than it is under the present system. For would not the head office issue instructions to cease discounting or to restrict discounts whenever the bank's condition became such as to necessitate that action being taken?

The answer to the objection is that a properly managed branch bank, its management having full confidence in the soundness of general business conditions, would seek to complement the working of those branches at which the good loans showed a tendency to increase faster than the deposits by opening a series of branches in small places where there were no manufacturing or other businesses that would require large advances. By this means, and by means of the gradual accumulation of deposits at its older branches, with perhaps an occasional increase of capital stock, it would probably maintain the proper balance between its loans and deposits, and, the times being normal, it would likely be able to do its proper share of the work of supporting the industries and trades carried on in the districts where its branches were located.

When the Local Bank Has All Its Funds Employed

Now mark this difference in the working of the two systems: The local single-office bank, on being asked for

further advances when its funds are all loaned out, simply refuses to comply. The local would-be borrowers are thereby discommoded, and possibly they are prevented from engaging in business transactions that would have resulted in sure profits and perhaps in providing employment for additional workingmen. But the branch bank extends the accommodation, the security of course being satisfactory, and the projects of the applicants being such as the bank might with propriety support. In that case the local industries and trades get a better support than they could expect from the single-office banks. But that is not all. Owing to the demand for discounts emanating from this point and from others like it, hundreds of little places which can never hope to have a bank under the present system would be accorded banking facilities of the highest class. At all branches the people would be encouraged to develop to the utmost their natural bent, whether that bent was to borrow or to deposit; at all points the deposits and loans would be at the natural level, and a scientific and very effective distribution of society's deposit fund accomplished; while with the independent banks it is obvious that, except in the comparatively few cases where an equality of loans and deposits comes about through the deposit fund of the locality balancing naturally with the demand for discounts, one or other of the two items must be at an arbitrary or artificial level; and one or other of the two great sections of the people—would-be borrowers and would-be depositors—must be to some extent inconvenienced thereby.

Loans and Deposits by Geographical Divisions

The following table shows the situation in the different parts of the United States, so far as the national banks are concerned:

NATIONAL BANKS

September 1, 1910	Loans and Discounts	Deposits *
New England,	$ 477,310,961	$ 446,034,331
Eastern,	2,069,013,437	1,984,361,789
Southern,	664,412,284	552,622,615
Middle Western,	1,542,126,247	1,428,726,621
Western,	356,807,264	398,955,370
Pacific,	356,205,278	382,848,900
	$5,465,875,471	$5,193,549,626

* In the deposits are included "Individual deposits," "United States deposits," "Deposits of United States disbursing officers." Deposits shown in the abstract under the headings "Due to other national banks," "Due to state and private banks and bankers," "Due to trust companies and savings-banks," aggregating $1,925,875,470, are not included, because they represent, to a considerable extent, a duplication of figures.

It is safe to say that if a statement of the loans and deposits of the Canadian banks covering the several sections of the Dominion in which the business of each section was given by itself, could be studied, such a balancing of the two items would not be seen. The Winnipeg manager of an important institution, which covers nearly the whole Dominion, informed me that his bank had loaned in Western Canada at least three dollars to every dollar of Western deposits. And there is no reason to suppose that the condition of the other leading institutions is materially different.

When Loans and Deposits Are at Their Natural Level

The point is that if the loans and deposits were left to seek their natural level, as is the case under a proper system of branch banks, there would surely be in some of the sections of the United States a wide disparity between the two items. The fact that they are so nearly equal in every part of the country points to the conclusion that both are kept down to an arbitrary level—in some districts borrowers do not get the accommodation

to which they are entitled, and in others poor facilities are extended to depositors.

So, when conditions in the financial world are normal, the various offices of a strong branch bank are expected to do all the good business, deposits and discounts, that they can get or handle. It does not matter at all, in the case of a bank with a well-balanced system of branches, whether deposits or discounts heavily overbalance at any particular office.

Course of the Loans in Periods of Stringency

It may be conceded, however, that in periods of great industrial and commercial activity, when speculation is rife and prices are high, the increase of loans taking place generally at all branches in response to the increased natural demand for credits then effects a gradual absorption of the bank's surplus of liquid balances into its loans and discounts. Usually, too, during a period of this kind deposits will show a tendency to remain stationary, or perhaps to recede. Opportunities for the investment of capital are so numerous and inviting that the owners of cash funds are induced to draw down their deposits in order to take advantage of them. When the process of loan expansion has gone a certain distance the bank is forced to move cautiously in the matter of entering into new commitments. Unless it does so there will be danger of its cash reserves falling so low as to make its condition unsafe, and perhaps prevent it from pursuing a dignified course in meeting its daily balances at the various clearing-houses. Then it is to be expected that the branch managers will get instructions to put the curb upon their borrowing customers. The chief executive officer sees the condition of his own bank. He perhaps knows that other representative banks are in much the same case, and his experience teaches him that the country may be speeding toward a crisis or revulsion of

some kind. Therefore, it may be said that when the condition of a large and well-managed branch bank becomes such as to cause its executive to withhold accommodation from good borrowers, the chances are that it is in the real interest of the borrowers to have their credits curtailed and their operations depending upon credit reduced to smaller volume.

The Cases of Jasonville and Thompsontown

This seems to be a suitable place to refer to an editorial which appeared in the Philadelphia *Saturday Evening Post* on February 13, 1909. As it expresses aptly the opinion held by a large number of people in the United States, it is reproduced. The article says: "The Canadian banking system is much admired in this country by theorists and by certain metropolitan financiers; but whenever its adoption is urged some ten thousand country banks rise up to protest.

"Our country bank is decidedly a local institution; local men own and operate it with an eye single to local conditions; it is chock full of the town's spirit. A branch bank, on the other hand, would belong to New York or Chicago. To its directing mind—regarding Jasonville impersonally as merely one of several hundred units—it would be a matter of complete indifference whether the new canning factory located there or at Thompsontown, ten miles beyond. That our independent country bank is, on the whole, the more useful institution seems to us incontrovertible."

The Branch Bank and Local Development

The whole of this book is devoted to the purpose of controverting the idea that the small local bank is more useful than the branch. I hope it will be conceded that something has already been done along that line. With reference to the editor's statement that the directing

mind of a great branch bank would be completely indifferent about the campaign over the new canning factory, it can be said that he would not be indifferent any more than the president of a great railroad system is indifferent about the establishment of new industries along his line of railroad. And in any case the manager of the local branch bank would not be indifferent. If the canning factory comes to Jasonville and he succeeds in getting the account, it will increase the business and profits of his branch, and perhaps lead to an increase of his own salary. Therefore, the branch manager fights stoutly side by side with the other Jasonville citizens for the acquisition of the factory. And, further, when the factory is established he will get for it a credit which will be infinitely more valuable to it than any credit the local bank could give. If there is a reasonable prospect of the factory proving a success, and if the proprietors are able and willing to furnish security that will make the bank's position safe, the branch manager will have little difficulty in obtaining the approval of his executive superior to the credit for the new account.

But if the thing is clearly doomed to failure, or if the proprietors of the factory aim to get large loans on inadequate security, or on no security at all, the credit will not go through. And it is as likely as not, if loans are made to the canning interests on this basis by a purely local bank, that both the stockholders of the bank and the citizens who interest themselves in the new industry will suffer loss.

A Branch versus a Local Bank

I shall now undertake to describe in some detail the relations existing between the banks and some classes of their customers. In order to make the description lucid I shall make use of a couple of hypothetical branch banks, and explain just what the people might expect from them in the way of facilities and accommodation.

It will, of course, be necessary to picture conditions in two or more parts of the country, so as to cover a few of the great forms of activity in which Americans are engaged. It has occurred to me that an interesting picture might be drawn of a competitive struggle between a typical local bank of the present day and a typical branch bank, for the business of a moderate sized country town, let us say in Massachusetts, which devotes itself, to some little extent, to manufacturing.

We may suppose that in the town selected for illustration there is but one bank, and it does a thriving business. It has a capital of $100,000, a surplus of $50,000, and total assets of about $900,000. The bank has on its board half a dozen of the most substantial business men in the place, and the stock is scattered among the citizens. Perhaps a couple of the local manufacturers are on the directorate.

The Bank of Massachusetts

Let us for the sake of illustration assume that the laws of the United States have been broadened and liberalized so as to permit the organization and practical operation of large branch banks of the Canadian pattern of mercantile banks—that is to say, employing the bulk of their resources in mercantile loans and advances, and keeping in cash and at call only enough to enable them to go their ways with dignity and to meet emergencies without straining. Now it happens that the Bank of Massachusetts — a hypothetical branch bank of this description, with capital of $10,000,000, surplus of $5,000,000, total assets of $150,000,000, and some one hundred and fifty branches, largely in the State of Massachusetts, but not confined to that state—wishes to establish a branch in the hypothetical town to which I have referred. As the bank has been quite largely built up, or, rather, evolved, through absorbing local single-office banks, it first endeavors to induce the local bank which is in sole

possession of the field to merge with it and become one of its branches. For the stock of the local bank it offers a price slightly higher than the level at which it has been selling, and invites the stockholders to accept its own stock in payment at the market rate, as established by transactions in the Boston Stock Exchange. The executive officers of the Bank of Massachusetts are able to make this offer, because they know from experience that, operating this local bank as a branch, they can make it earn more on its stock than it earns in its independent condition. However, the local directors and stockholders do not wish to give up their individuality, or to lose the identity of their local bank, of which they are justly proud. Then the Bank of Massachusetts decides to open a branch in opposition and to build up a business of its own. This gives a good opportunity of studying the methods that would be resorted to by branch banks, and also of comparing the usefulness to the locality of the two kinds of institutions. It is to be remembered that there is no legal compulsion either way upon the inhabitants. Owing to its local organization, the local stockholding and its established footing, the bank already on the ground has all the advantage. It may be supposed that the sympathy and sentiment of the townspeople and of the people of the surrounding country would be altogether on its side. If the branch bank succeeds in building up a profitable business under these circumstances it must positively be because it extends facilities which the local business men cannot afford to ignore. Assuming that a thoroughly capable man is appointed as manager of the branch to be established, let us follow him in his handling of the bank's affairs.

Policy of the Branch Manager

First of all there is the matter of premises. The bank must be housed in a suitable building in a central loca-

tion. Its premises must be compatible with its dignity as a powerful institution. It might be necessary to provide a building of its own. If that were done the plans therefor would take account of the kind of building possessed by its local competitor. It would be seen too that the local bank did not outclass it in the matter of a building. On the building the bank's sign, "Bank of Massachusetts," would appear with impressive simplicity. And in large letters on the window screens would be seen the legend, "Capital $10,000,000, Surplus $5,000,000, Total Resources $150,000,000." Possibly the window screens would also bear the intimation that interest was allowed on deposits.

One of the earliest arrangements made by the branch manager would be the engagement of a lawyer or solicitor. A man would be selected who was not already retained by the local bank—preferably a man in position to influence business and desirable accounts. To him it is explained that he will get at regular rates all the law business of the Bank of Massachusetts and of its branches emanating from this locality. In return he is expected to keep his whole account at the branch and ally himself with it. If this is more than he wishes to undertake the appointment of course will go to some other lawyer, providing one with the requisite ability can be had.

The Record of Ratings and Characters

This ally gained, the next step is to procure reliable information about all the business men in town, and about the principal farmers and other residents of the tributary district. By the aid of mercantile agency reports, of records in the bank's head office, and of particulars gleaned from parties in town who can be depended upon to give reliable data, the matter of the financial standing of everybody who may apply to the bank for loans is gone into as thoroughly as possible. It would not be difficult

to find confidential advisers of this sort who could be depended upon. The information they furnish is checked up by inquiry from other sources, and the whole classified and arranged so as to be readily accessible. All this need not necessarily be taken as accurate; each item has only its certain standing as So-and-so's estimate. Subsequent dealings will, in a number of cases, provide the means of verifying or revising the estimates secured.

It is the bank's intention, while the general situation throughout the country is sound and free from alarming signs, to refuse no request for credit made by a worthy applicant who offers adequate security and who proposes to embark the proceeds in something the bank may safely and properly support. And it is necessary to direct the preparations in a careful and scientific manner.

Making Use of Outside Connections

For the formal opening a staff must be got ready. A trained man will be drafted from another branch as second in command. At the outset he probably will fill a position in which the duties of manager's lieutenant and teller are consolidated. Then a bright young local fellow will be enlisted as junior. This staff of three will suffice for the beginning. Next, the manager will take steps to ascertain which of the local business men have close relations with the bank's clients in other places. It may transpire that some large Boston house connected with the bank, or some house in another city that is beholden to it, can influence or control the banking business of one or moṙ local concerns. If the local accounts are desirable this outside influence may be evoked, perhaps resulting in the acquisition of a few good accounts.

As the existing local bank has been alone in the field, it is possible that its rates of discount have been rather high in the cases of a number of accounts. On the appearance of opposition perhaps these high rates would

come down. The customers thus affected accept the reduction, but they have, all the same, a kindly feeling for the new-comers whose advent was the cause of their better fortune. The branch manager is satisfied to leave it at that for the present. He has no intention of inaugurating a rate-cutting war. He wants business, to be sure, but it must be profitable business.

The Chronic Malcontents

Everybody who has had much actual experience in the banking business must have noticed that in practically every town or community are to be found a few customers with whom it is next to impossible to preserve cordial or amicable relations. No matter how well they are treated they are always seeking occasion for quarrels. Not infrequently their business is of some considerable value to the bank; but its value is constantly overshadowed by the unpleasantness of the relations with them. Possibly a couple of these chronic malcontents will transfer their accounts immediately the new bank opens, but it is by no means certain that their business will be retained for any length of time.

So far nothing very important has been achieved by the new-comers. The general body of the town business holds firmly to the local bank. Indeed, no earnest, direct effort has been made to dislodge it. However, the Bank of Massachusetts had a definite end in view when it decided to open this branch. It was because of the confidence it had that its end would be attained that it built its local premises. The actions and policy of the branch manager, heretofore described, are merely the preliminary moves in the campaign.

The Manufacturers' Accounts

It has been mentioned that there are a number of rather extensive manufacturing plants located here. The

accounts of these manufacturers constitute the chief prize which the Boston executive aimed to secure. Before, however, making advances of any kind, the branch manager, with the assistance of his head office, satisfies himself thoroughly as to the financial responsibility, the character, and record of each one of the various manufacturers, and makes himself familiar with the nature of their businesses, the markets they sell in, the products they make, their prospects, etc. Let us assume that there are five plants, two of which are extensive, while the others are of moderate size. The owners of the large plants are wealthy and A1 risks—one of them is a director of the local bank. Of the three smaller plants two are owned by parties whose financial strength is considerable enough; but it is suspected that the owner of the fifth plant is laboring a little.

Though these manufacturers—the four of them at any rate—are well rated, and though all in the neighborhood consider them wealthy and safe, they require to borrow every year more than the local bank can give them. The banking law, of course, strictly limits the direct advances which a bank may make to any one borrower; and even if the law did not impose this restriction the dictates of prudence and common sense would prevent any banker worthy the name from putting half or two-thirds of his resources into one loan, no matter how good it might be. If that were done the rank and file of small borrowers in town would raise such a disturbance as would bring opposition at once. So the position of the manufacturing interests here, in regard to banking accommodation, was what it must nearly always be under the system of local single-office banks—unsatisfactory and tending to restrict their operations unnecessarily.

The Manufacturer and the Note-Broker

One of the large concerns has required to borrow $400,000 at a certain season of each year when stocking

up with raw materials. At this season it could use $600,000 quite conveniently, but the unsatisfactory borrowing conditions have deterred it from undertaking more than $400,000. To raise this sum it has to be beholden to perhaps a score of banking institutions in different parts of the United States. These banks hold the paper in lots of anywhere from $5,000 up to $50,000. The local bank customarily takes $10,000 directly, and will perhaps lend $40,000 or $50,000 on trade paper or in some indirect way so as not to violate the law. All the paper, except the portion taken by the local bank, is placed through a note-broker in New York or Boston. This broker asks for full particulars of the manufacturer's position. Sometimes he gets them and sometimes not. When he has all the information possible, he circularizes his list of clients, composed of banks and private investors, inviting each to take a part of the notes offered. Though the operation is pleasantly described as placing the notes upon the market, it amounts in effect to an application by the manufacturer (whose business is strictly a private business) for credit, addressed to all these parties. Any of them, with or without the inclination to purchase, may ask for the details of the manufacturer's position, his balance sheet, and profits, if he has furnished all that information. To a high-spirited borrower this comes as a detestable necessity. Plenty there are who cannot bring themselves to submit to it. Sooner than do so they forego the sure profit attendant upon borrowing—preferring to restrict their operations and to decline orders from would-be customers. Other considerations than that of preserving their self-respect operate to induce them to follow this policy of restraint. Should a financial crisis develop in New York, or in other parts of the country, they are threatened with the fate that befell the Westinghouse Company in 1907, because of the diffusion of their indebtedness among so many holders none of whom has any but a passing interest in them.

Borrowing from a New York or Boston Bank

There is another way in which a large borrower in the interior of the United States may get the accommodation which his local bank is unable to provide. He may get a line of credit from a large New York or Boston bank, and dispense with the note-broker altogether. I understand that a considerable business of this kind is done. It is an awkward attempt at adopting some of the conveniences of branch banking. The borrower in this case looks to a far-away executive for his loans exactly as do most of the borrowers under the branch system. But under the branch system the borrower is able to negotiate with a sympathetic and influential intermediary living in his own town and acquainted with his business.

What the Branch Bank Offers to the Manufacturer

This description of the financial conditions under which the local manufacturers had been working is sufficient to give the reader an idea as to the feelings with which they would welcome what the branch manager had to offer them. To this man, who had been borrowing $400,000 through the agency of the note-brokers, the branch manager proposes that application be made to the Bank of Massachusetts for a credit of that sum, or of half a million. The rate of interest would be the same as he had been paying; the credit would remain open during the manufacturing season, and the loans would be expected to run down and off in the natural course of the manufacturer's business. If the credit be approved the bank would stand ready, all through the season, to advance funds in the manner agreed upon and as its customer needed them, up to the maximum named; its extensive system of branches and correspondents would be at his service for making collections from his debtors, and for providing him with information regarding them; it

would aid him and advise him to the best of its ability, as it would be deeply interested in his success. Within certain well-defined limits it would back him and support him in developing his trade, almost as if it were a partner. Should a panic or a crisis develop, being so heavily involved with him, its interest would lie in enabling him to meet his outside liabilities. For it to suffer him to fail would endanger the advance, and might have some effect in provoking a run of depositors. Also, its reputation and credit would be involved in its seeing its worthy customers safe through the disturbance.

The Advantages in the Branch Bank's Proposition

Can any one doubt what decision the average American manufacturer would take on having a proposition of this kind submitted to him by a bank of the type of the Bank of Massachusetts? Even if the local manufacturer here referred to were a director of the local bank there is hardly room for doubt as to his decision. If the proposed arrangement worked out as the branch manager said, and there was every reason to think it would, it meant freedom from the necessity of publishing his affairs for the benefit of a large body of individuals for whom he did not care a button, and who took but the slightest interest in him. Better than all, it meant more profits. If the scheme worked smoothly and pleasantly the first year, why he might next year apply for a larger sum and take the orders of the parties he had had to turn down. After a couple or three years it might be that he could use eight hundred thousand or a million without laying himself open to the charge of over-extending himself.

So he decides to apply for the credit and to transfer his account. He feels that he cannot ignore the advantages which the branch institution holds out to him. For his business the branch bank is incomparably more

useful. As the Bank of Massachusetts' loans enable him to make more profits, and with them to enlarge his capacity and increase his force of workmen, the bank in this respect benefits local industry to a greater extent than does the local bank.

The Branch on a Paying Basis

As for the new branch bank, the acquisition of this one large account will probably put it upon a paying basis. And, as the arguments which were successful in the case of this first manufacturer will possess an equal force with his brother manufacturers, there is no reason to suppose that they will be less ready than he was to take the proffered advantages. Assuming that, in the course of a year or two, three of the good manufacturing accounts were obtained, and head-office approval secured for their applications, it is altogether likely that the branch would have a discount business of considerably more than a million dollars, with excellent prospects of further increase. It is worthy of special notice that although the new branch is now transacting a larger business in loans than the earlier established local bank is transacting, it has taken only a small part from its local competitor. The bulk has been taken from the note-brokers and from distant banks which do not notice the defection. And part of the new loan business is newly called into existence and represents a distinct addition to the industrial power of the country.

VI

A HYPOTHETICAL BRANCH BANK (*Concluded*)

The Bank of Massachusetts' Deposit Branches

AS it will not perhaps be exactly clear to some readers how this branch bank could, at a point where it had little or no deposits, place a million dollars at the disposal of the local industries, I shall, before proceeding further with the story of the development of the branch's business, describe the methods and policy by which this million and many others like it are produced. A brief reference has already been made to the fact that a well-governed branch bank will complement a branch at which the loans exceed the deposits by establishing another branch at a point where deposits will exceed the loans. Very likely the Bank of Massachusetts will be obliged to open eight or ten new offices in order to complement or balance the operations of this branch it has just opened in the small manufacturing town we haye been dealing with, and which we may call the town of X. Now let us see in what kind of places these complementary branches are planted, and what kind of business it is that they transact.

There are in the United States thousands of quiet country villages possessing no manufactures or other enterprises that call for the extensive use of banking credits. A few stores, a couple of hotels, a blacksmith shop or two, one or two agents or dealers handling agricultural implements, may comprise the business establishments of a place of this kind. Its population may be

anywhere from two hundred to thirteen hundred. It has no bank. A national bank would be out of the question, for there would be no employment locally for the deposits it would get, to say nothing of its capital funds, which must be not less than $25,000 according to law. Neither is there any inducement to start a state bank. The place is sleepy, nearly devoid of enterprise. A note-shark capitalist may, however, be found there, and if so he probably fleeces the poorer farmers of the neighborhood, and the citizens too, whenever he gets the chance. Neither the farmers nor the townspeople have enough confidence in him to entrust him with their deposits. Consequently, while a few go to the trouble of sending deposits by mail to banks in distant cities or towns, the majority of the people govern their financial affairs as they would if there were not any banks in the country. They keep cash in their houses and stores and on their persons; their payments are made altogether in cash.

Relations with the Rural Classes

Into this little place comes the Bank of Massachusetts with all the prestige of its immense resources. Manifestly the conditions here are vastly different from those obtaining in X. There the bank aimed at the acquisition of a large discount business. To handle the large manufacturing accounts and the other business it was necessary to have a skilled manager and to pay him a good salary. But here the business will be mostly deposits. Such loans as are asked for will be small and easily handled. A highly paid manager is not required. Some teller or ledger clerk will be assigned to the post at an increase over his previous salary. He will be given a junior, suitable premises will be rented or provided, and the bank is ready to begin business. It is to be expected that all the local business men will avail themselves immediately of its facilities. They will be trained to de-

posit their receipts and to pay by checks on the bank. Then there will be a number of farmers and village householders who will take the first opportunity of placing their cash at interest in an institution clearly deserving their confidence, and thus relieve themselves of the anxieties attendant upon hoarding. From bureau drawers, from hiding-places and improvised safes, from pocketbooks and wallets, would come a steady stream of deposits. In a couple of months even a very small place of this description in the East might furnish $40,000 or $50,000 of deposits, and thereafter the amount should tend to increase steadily. In a couple of years the bank might have $140,000 on deposit and perhaps $25,000 under discount. Though the branch is intended primarily as a feeder for other discounting branches, there is no attempt whatever made to keep down the loans. On the contrary, the local manager tries to develop the loans to the full capacity of the district. He does so because the more he can increase his good loans the more profitable will his branch become, and the higher will he stand in the estimation of his general manager. For small loans made to the townspeople or the farmers in this place the bank will get a higher rate of interest than it gets from the wealthy manufacturers at the other branch. Therefore, the manager lends a willing ear whenever he is approached by any customer or resident whom he knows to be worthy and responsible and who wishes to discount satisfactory paper. Reliable farmers who wish to pay their hired help, to pay cash at the stores, or purchase implements, etc., before they have received payment for the season's crops; local butchers and live-stock buyers, contractors and builders, grain buyers and dealers in the produce of the locality, find in the branch a steady ally whose assistance can be depended upon in any weather so long as they themselves keep their credit good; and the local merchants find that when they convert the book debts owed them by good farmers and by good citizens

into notes the bank will discount them, and that the proceeds of the discounts permit advantageous buying of fresh goods for cash, or an enlargement and improvement of stocks on hand without a further investment of capital.

Sending Away the Surplus Deposits

But, in spite of all the efforts of the local manager to find good borrowing customers, it will likely happen that the growth of the deposits far exceeds the development of the loans and discounts, and that the bank has an increasing amount of the local funds available for use in other places. Here is encountered one of the chief arguments used by the champions of the single-office banks in their assaults upon the branch idea. They brand it as almost a crime to collect the deposit fund of a locality through the agency of a branch bank and then to lend it in a different section of the country. "The inhabitants of a locality served by a bank of this description," so they argue, "are deprived of the use of their own money, which, instead of being used to build up the home village, is applied to the upbuilding of distant towns and cities." I think, however, that a great many of my readers who have patiently followed me thus far will agree with me, on considering the matter, that it is absurd to say that the village here described is injured through the operations of the Bank of Massachusetts' branch. On the contrary, the people of the locality derive a number of important benefits from the operation of the branch which they would never have gained if their country were served exclusively by single-office banks. But for the branch system the place probably could never hope to have a bank at all. The capital which the branch collects and sends away lies sterile. It is kept in iron safes, in bureau drawers, old stoves, under rag carpets, and in people's pockets. Surplus funds, or other funds accumulated for special purposes, which are carried in

that fashion are of little use to anybody or any place, least of all to the place to which they belong. A branch bank can live there because it operates more economically than an independent bank, and because a very small net profit on the operations will be satisfactory to its managers. Nay, the branch taken by itself need not give a profit at all. Its operations are considered in conjunction with those of others. Thus it may happen that four branches, each supplying $100,000 for use of other branches, will be bracketed with another branch which is using $400,000 of the funds of other branches. The net result from the combination of the five branches will, perhaps, be an annual profit, after paying all expenses, of, perhaps, $2,000 per year, and they not using one cent of the bank's capital. This will, perhaps, show that branch banks will penetrate into much smaller places than can the independent banks. The thousands of places which possess no banking facilities at all, or facilities of the most wretched description, would gain facilities of a superior kind in a short time if a proper system of branch banking, free from unreasonable restrictions, were inaugurated. Think you the people of any of those little places, when they learned that they were to have a branch of some great banking institution, would consider that they and their locality were in any way endangered or imperilled thereby? Not at all. Their big bank would be their chief boast; and their local paper, if they had a local paper, would never weary of referring to it as an evidence of the confidence entertained by the financial powers in the future of the locality. At least that is how all the little places in Canada take it when they acquire branches of good banks.

A $5,000,000 Bank in a Village with Population of One Hundred

I am penning this chapter at a little country place in the Niagara Peninsula in the Province of Ontario. The

population is, perhaps, one hundred and fifty souls. It has no bank. A mile and a half to the east lies another village with a population of about five hundred. Here one of the strong Canadian banks has a branch. Last year, the third year of its branch establishment, the bank erected a building to serve for its office and for the residence of the manager, which must have cost $6,000 or $7,000, and is, apart from the churches, the show place of the village. Then, two and a half miles west, is another village with about three hundred and fifty population. This has a branch of a bank with a capital of over $3,000,000. A few days ago while driving over the Peninsula we went through a tiny hamlet which could not have had more than one hundred population. The only business places I could see were a hotel, a store, and the warehouse of an agricultural implement dealer. I knew it had a bank, but did not at first see the office. "Where is the bank?" I asked my companion. "There you are," he said, pointing with his whip to a very diminutive house farther along the road. But, mean though it looked, that building was dignified with the name of one of Ontario's powerful banks—an institution possessing more than $50,000,000 of assets. After the bank's name appeared the legend, "Capital $5,000,000, Reserve Fund $5,000,000. Open Tuesdays and Fridays." This is what is known in Canada as a sub-agency. One of the larger branches of that bank in this district sends two men on Tuesdays and Fridays of every week to the sub-agency. They take a supply of cash with them, and receive deposits, make loans, and cash checks for the inhabitants; and then take the discounted notes, the cash, and cash items back with them to the parent branch. In this way the branch banks of Canada get close to the people of the rural districts, and the rural districts derive nothing but benefit from the connection. The people living in lonely farm-houses in Canada are not forced to keep sums of cash in hand because of the lack of con-

venient banking depositories. Within easy distance there is sure to be a branch of some bank in which the farmers have implicit confidence. And into the branch their moneys go at once. The general habit of depositing, and the general confidence of all classes of the public in the strength of the banks, have a tendency to lessen burglaries —for the burglars, as a class, have come to know that there is but a poor chance of finding any cash even in the houses of the well-to-do farmers.

Another Field in Which the Local Banks Are Weak

To return to the affairs of the Bank of Massachusetts, I might observe that the bank, in searching for deposits to offset the heavy loans of certain of its branches, would perhaps establish some offices in another field which is but scantily served by the present system of local banks. Boston itself and the other large United States cities comprise that field. To illustrate my meaning the following is submitted: Early in 1908 the National Shawmut Bank of Boston absorbed the National Bank of the Republic. That transaction reduced the number of national banks in Boston to twenty-four. In the year preceding that in which it was swallowed into the Shawmut the National Bank of the Republic had itself absorbed the Freeman's National. Thus, where there were three banking offices there is now but one. The Shawmut has grown larger and stronger, but two banking offices in Boston have disappeared in bringing it to pass.

Boston's Banking Facilities

There were in Boston in 1898 fifty-seven national banks; in 1903 the number had fallen to thirty-eight. Then, in 1908, it had fallen to twenty-four—a net reduction in ten years of thirty-three, or more than 50 per cent. During 1909 the number of national banks was

further reduced to twenty-three. Two banks went into liquidation, and one new institution was formed. The reduction has occurred as a result of consolidations, liquidations, and failures. If, instead of taking the national banks, the member banks of the Boston Clearing-House are taken, the reduction in banking facilities is seen to be even more startling—for in 1898 there were fifty-three, and in 1908 there were but nineteen.

Economy of operation has been one of the chief objects aimed at in the mergers. It has unquestionably been attained, since in 1898 the fifty-seven national banks, on their aggregate capital of $49,650,000, paid an average dividend of 2.3 per cent., while the twenty-three national banks in 1909 paid an average dividend of 7.2 per cent. on an aggregate capital of $23,300,000. An official of one of the oldest banks in Boston, commenting on these figures, acknowledged that the tendency of the banks to consolidate had brought inconvenience and hardship to retail business interests especially. Referring to one of the recent mergers he said: "I believe the effect of the consolidation is bad so far as the mercantile interests are concerned. The few banks remaining are larger than formerly, and are less willing to give attention to the small merchant, who is finding it increasingly hard to borrow from the banks. There are, of course, large economies effected, expenses greatly reduced, and increased dividends paid to stockholders, but it is hard sledding for the little fellows. To be sure the trust companies are of late years doing more or less of a banking business; but in Boston I should say that one-half of them will not loan to depositors except on collateral."

Conditions in Other Cities

These same conditions are more or less in evidence in the other large cities. In Chicago, for example, as the New York *Financier* pointed out, there are a great many

small merchants and business men who are obliged to travel from two to six miles in person or by messenger to make a deposit. The movement to consolidate is altogether a natural one, and the banks cannot in fairness be blamed, because it results in a steady shrinkage in the facilities extended by them to the public. Banks are commercial organizations, and for the managers of the respective institutions to seek to increase their profits, their strength, and solidity by lawful means is entirely right. The fault is with the system of banking which makes it well-nigh impossible to effect the desired financial strengthening and increase of earning capacity through consolidation without closing many banking offices that had been supplying much-needed facilities to certain urban districts. I am aware that a few banks do operate branches in certain cities, but the conditions under which a branch may be operated, in those states that permit them to exist, are so onerous as to amount almost to prohibition. If the conditions were such as to allow the city bank profitably and conveniently to operate an absorbed bank as a branch, doubtless it would gladly do so, and the inhabitants of the cities would continue to have the benefit of banking facilities they had enjoyed before the consolidation took place.

How the Canadian Cities Are Served

Contrast the conditions prevailing in Boston with those found in the principal Canadian cities. In November, 1909, there were in Toronto one hundred and fifteen branch banks; in Montreal there were eighty-three; in Winnipeg forty, and in Vancouver thirty-five. In Toronto one important bank had no less than seventeen branch offices; another had twelve, and another ten; while in Montreal one bank had thirteen branches; another eleven, and a third had ten. In all the Canadian cities the number of banking offices is constantly increas-

ing, notwithstanding that the number of banks in the Dominion tends to decrease. Because the establishment of branches is left free and unrestricted, and is not unduly taxed, the resident of every part of a Canadian city has a good strong bank within a couple of blocks of his door. In the retail district the branch offices are thickly scattered, also in the residential districts and in the factory districts. They extend even into the suburbs. Thus, through the working of the branch system, nearly every Canadian city has more banking offices than an American city twice or three times its size will have; and all the residents benefit therefrom.

Bank Amalgamations in Canada Do Not Lessen the Facilities

These urban branches are, of course, like the country branches, open to discount all the good paper offered them. But, except those located in the midst of the factories, they usually have a considerable excess of deposits. They are used most extensively by business men, professional men, by housewives and their daughters for personal accounts. The owners of the stores and business establishments also find them a great convenience and a source of considerable profit. Banking amalgamations and consolidations are as plentiful, relatively, in Canada as in the States, but, because Canada has the branch system, consolidation there is not attended by a withdrawal of banking facilities from the public.

A Comparison of Facilities

In order to show the value of the facilities provided by the Canadian branch banks to the residents of the cities and larger towns I have compiled a list of the principal cities in the United States and Canada, and a comparison of the number of inhabitants per banking office.

The statistics for the United States cities are taken from the *Rand-McNally Bankers' Directory*, 1908, and for the Canadian cities the number of banking offices from *Houston's Bank Directory* for November, 1909, and the population from *Bradstreet's Reference Book* for 1909. The difference in dates is not unfair to the American cities, inasmuch as in some cities the number of banks has since decreased through amalgamation or liquidation (Boston is one example), while the population has increased, and in others any increase in the number of banking offices would be accompanied by an increase of population perhaps to such an extent as to leave the number of inhabitants per banking office at about the same figure. I would point out, also, that I have favored the American cities through counting all trust companies as banks, along with state banks, savings-banks, national banks, etc., while in the Canadian record I have included only the chartered banks, and in Montreal the Montreal City and District Savings-Bank. In the *Rand-McNally Directory*, at the end of the list of banks in each large city, appears a list of brokers, bankers, and investment concerns. These I have not included.

Banking Offices and Population

UNITED STATES CITIES

	Population	Bank Offices	Inhabitants per Bank
Chicago,	2,300,500	84	27,400
Philadelphia,	1,293,697	108	12,000
Boston,	595,380	65	9,100
St.Louis,	575,238	53	10,800
Baltimore,	508,957	53	9,600
Cleveland,	381,768	43	8,900
Buffalo,	376,587	18	20,900
San Francisco,	342,782	56	6,100
Cincinnati,	325,900	41	7,900
Pittsburg,	321,616	*96	3,350
Detroit,	317,591	21	15,100
New Orleans,	287,104	24	12,000
Carried forward,	7,627,120	662	143,150

* Includes 20 trust companies and 32 savings and trust companies

UNITED STATES CITIES—*Continued*

	Population	Bank Offices	Inhabitants per Bank
Brought forward,	7,627,120	662	143,150
Milwaukee,	285,315	18	15,800
Minneapolis,	261,974	24	10,900
Washington,	218,196	32	6,800
Louisville,	204,731	23	8,900
St. Paul,	197,023	13	15,100
Providence,	175,597	21	8,400
Indianapolis,	169,164	19	8,900
Kansas City,	163,752	22	7,400
Denver,	133,859	18	7,400
Columbus, Ohio,	125,560	28	4,500
Omaha,	102,555	7	14,600
Memphis,	102,320	21	4,900
Portland, Ore.,	90,426	20	4,500
Atlanta,	89,872	15	6,000
Richmond,	85,050	21	4,000
Seattle,	80,671	26	3,100
Des Moines,	62,139	21	3,000
Charleston,	55,807	14	4,000
Savannah,	54,424	12	4,500
Salt Lake City,	53,531	13	4,100
Spokane,	47,006	14	3,400
Dallas,	42,638	11	3,900
	10,428,730	1,075	9,700

CANADIAN CITIES

	Population	Bank Offices	Inhabitants per Bank
Montreal,	*400,000	83	4,800
Toronto,	328,911	115	2,800
Winnipeg,	130,000	40	3,300
Ottawa,	80,284	30	2,700
Vancouver,	80,000	35	2,300
Quebec,	68,840	22	3,100
Hamilton,	62,000	22	2,800
Halifax,	50,000	10	5,000
London,	48,000	16	3,000
St. John, N. B.,	40,711	13	3,100
Victoria,	35,000	8	4,400
Calgary,	29,265	16	1,800
Edmonton,	22,500	14	1,600
Fort William,	18,000	10	1,800
Brandon,	10,409	9	1,200
Regina,	10,000	10	1,000
	1,413,920	453	3,100

*In Montreal's case I have taken the estimated population of the suburbs as well as of the city proper, because the 83 banking offices include branches in the suburbs.

Better Facilities for City Residents

The foregoing illustration explains what further steps the Bank of Massachusetts would take in its search for deposits to supply the capital needed by its discounting branches. If the laws and other conditions permitted it to do so it would establish perhaps a score, perhaps two score, branches in Boston city. At every point where deposits might be secured, or a loan business done, in the retail districts, in the factory districts, in the residential districts, and in the suburbs, its handsome branch buildings would be found. Perhaps twenty branches might supply, on the average, $250,000 or $300,000 each to the parent office (in Montreal and Toronto some of these urban branches have very large deposits).

Now, has any reader the hardihood to say that the establishment of these offices in sections of the city which had previously no banking facilities would do the localities an injury? If the banks were properly constituted the opening of the branches would be regarded, in many humble homes and in many humble business places, as an unmixed blessing.

Small Local Banks Encourage Monopolies

Before resuming the narrative of the operations and development of the branch in X I wish to draw attention to a peculiarity of the banking practice and business in the United States which has important economic effects. Doubtless it will come as a surprise to many readers to be told that the existing system of isolated small banks tends in any way to encourage the creation of monopolies and trusts. But it is quite easy to prove that in several respects the system has tended to bring about a set of conditions favorable to the creation of combinations operating with huge capital, and decidedly unfavorable to the man with moderate capital who desires to embark

independently in manufacturing, or in some line of mercantile business.

The Example of Newfoundland

There is in North America one interesting example of a people experiencing a change from the local to the branch banks. It is to be found in the British colony of Newfoundland. From about 1856 the business of that island was in the hands of two local banks—the Union Bank of Newfoundland and the Commercial Bank of Newfoundland. These banks both failed on the same day—December 10, 1894. For a dark and gloomy period of two weeks—from the 10th to the 24th of December—the Newfoundlanders had no banking facilities and practically no circulating medium. They suffered terrible losses as a result. On the 24th the Bank of Nova Scotia established a branch at St. John's, and was followed, a few days afterward, by the Bank of Montreal, and in six months by the Merchants' Bank of Halifax—now the Royal Bank of Canada.

A circumstantial account of the affairs leading up to the failures and the succeeding events has been contributed to the *Nova Scotian*, March, 1909, by Mr. W. W. Watson, the manager of the Bank of Nova Scotia, who opened the St. John's branch, and who took an active part, along with the managers of the other two banks, in rebuilding the shattered finances of the colony. The bank failures were due to a cause that figures prominently in the record of failures of banks of the local type—large loans to enterprises in which the local directors were interested. Mr. Watson explains, too, that the local interests controlling the banks kept the benefits jealously within their own clique or set. Traders and customers outside of that had little chance of getting accommodation. When the Canadian banks went into Newfoundland they reconstructed the colonial finances, provided

an adequate supply of currency in the form of their own notes, lent money to the Government, and extended accommodation to all worthy borrowers without regard to whether they belonged to any particular clique or party. The *St. John's Trade Review* in December, 1907, published the following description of the change effected: "The thirteen years that have elapsed since the bank crash have wrought many changes in our commercial and social life, and on the whole we have progressed. Three factors make up the sum of our material betterment—namely: bountiful sea harvests, increased labor in mine and forest, and the introduction of the Canadian banks. Prior to the advent of these banks half a dozen men held the business of the country in the hollow of their hands, and woe to the unfortunate wight who endeavored to butt into the ring. But with the new order there was a fair field opened to every young business man with small capital and reputable name, and hundreds availed themselves of the opportunity. This not only led to keener competition, and consequently lower prices for the consumer, but it also led to a quickening of the business pace all round."

The Large Corporations Are Not Inconvenienced

Possibly the reader will find in this short sketch a strong hint as to some ways in which local banks encourage monopolies. Pursuing the subject to a more particular and precise definition, here is another way in which they tend, innocently and indirectly, to bring about the same undesirable result. It has been explained that the manufacturer or merchant in the United States who wishes to borrow a large amount, and who does not control a banking institution or a considerable interest in one, is obliged usually to float his paper through note-brokers in the principal cities, or to apply to large banks in those cities.

When a great railway company, the operations and financial position of which are well known to bankers and investors in every part of the country, wishes, through its fiscal agents, to place its bond or short-term note issues on the market while monetary conditions are normal, it can do so without difficulty or trouble. Similarly, when a large industrial or mercantile company, possessing a good reputation everywhere for financial strength, essays to do the same thing, bankers and investors in all the states have confidence that the obligations are good, and buy them freely when in funds. As we descend the scale, however, and come eventually to manufacturers and merchants operating in a smaller way, and not so well known to the investing classes, it becomes a more difficult matter for them to get the credits needed for carrying on business, though they may, in many instances, be quite as worthy of financial assistance, and quite as sound and safe for their requirements, as are their larger competitors and fellows. It can be seen, also, that after a certain point is reached one comes to a class of merchants and manufacturers, with only a local name and reputation, who are not big enough to command the support of this outside credit market. They are thus confined to their local banks, which, as already explained, are prevented by law and by regard for banking principles and their own safety, from advancing beyond certain small sums.

The Smaller Concerns Are Hampered

Now one may see how these conditions tend toward monopolies. A large, strong concern can easily get all the money it wants. The smaller, less-known concern gets credit less easily, and has to content itself with less than it can profitably use. In other words, the operations of the large concerns are carried on without difficulty or hindrance; those of the smaller concerns, the

requirements of which are beyond the capacity of their local banks to finance, are hindered at every turn. As already mentioned in the matter of the banking consolidations, there is no just ground for complaining of the conduct of the individual banks. It is perfectly right and proper for each particular bank to prefer to buy the easily marketable paper of a strong corporation rather than that of a little-known manufacturer operating in some small far-away town. That is correct banking; and the individual bankers are not to be blamed if the small borrower fails to get the capital he needs. But it counts in the indictment of the banking system, for it is clearly a defect of the system if worthy men with moderate capital cannot comfortably get the accommodation necessary for carrying on their business.

Branch Banks Support Both Large and Small Borrowers

I have explained in the preceding chapter what the branch banks would do for these smaller manufacturers. Under the branch system the great bank, with abundance of capital and credit to dispense, establishes itself at the very doors of these factories and mercantile establishments. It makes it a point to become thoroughly acquainted with the affairs, resources, reputation, and history of every borrower of the kind; and its officers are just as ready to fill the full requirement of a man who wants and is entitled to $50,000 as they are to meet the wishes of a borrower who asks for one or two millions.

It is quite possible that the oppressive combinations which overcharge consumers because of the monopoly they enjoy (in some part through possession of enormous cash funds or credit resources) would experience a much more vigorous competition if the able men throughout the country possessing a moderate capital and a good reputation could rely upon the support of good banks

free from trust domination. It would be reasonable enough to hope that from this cause alone the advent of branch banks would bring back competition in a number of trades and businesses where it now appears to be extinct. If they did so the fact would be of great benefit to the whole country.

The Domestic Bill of Exchange

There is another respect, closely allied to the foregoing, in which the present system makes it necessary for a business man engaged in distributing, jobbing, or manufacturing, to have a larger capital for carrying on his operations than he would need under the branch system, and which, therefore, works for the benefit of the so-called trusts. When I commenced my study of banking conditions in the United States several years ago I was struck by one curious fact: From what I can discover, hardly anywhere in the United States is there any extensive use, so far as internal trade is concerned, of the commercial bill of exchange or draft drawn by the merchant upon his debtor as a means of effecting collections and minimizing the capital requirement for carrying on business. There appear to be quite a number of sight drafts, but they are not commonly discounted or put to credit. The merchant or manufacturer sends them direct, for collection, to a bank in the drawee's town, and does not get his funds till the drafts are paid and the correspondent bank remits. Drafts at thirty days, sixty days, three and four months, are hardly used at all. Apparently the well-nigh universal custom, when a business man sells goods, is for him to wait for the maturity of the account or debt, and then he expects to receive a check. If the check is not forthcoming on the due date, he may then draw a sight draft and endeavor to get it paid. In some sections of the country these drafts are regarded by the drawees as offensive, as

being, in fact, next door to a lawyer's letter. This is a peculiar state of affairs. In other highly civilized countries the inland draft or commercial bill of exchange is an honorable and useful instrument, serving a very valuable purpose in economizing the use of capital in business.

Discounting Trade Bills

In all probability the drafts have fallen out of use because the merchants and manufacturers are not carried each one altogether by his own bank. A wholesale merchant in Montreal who ships goods all over the Dominion will have a line of credit with a large bank amounting to, perhaps, $500,000. When he applies for his credit the bank says: "We want commercial paper or trade bills. We won't make a direct loan to you, but will discount trade paper." This attitude of the bank is taken because of the well-known banking principle that bona-fide trade bills are better security than accommodation paper. Such an arrangement is better for the merchant too, for, though he may owe the bank $500,000, his liability is but indirect, and he has the powerful aid of the system of branches in effecting collection of his accounts. So, when he ships out his goods he allows time for them to reach the consignees, then sends down to the bank a batch of drafts drawn on his debtors in all parts of the Dominion—at sight, thirty and sixty days, three and four months—and the bank discounts the whole batch, providing the bills are on good parties. In this process the merchant gets his capital back within a few days after shipment of goods. He repeats the operation after each shipment. The prompt return of his funds operates mightily to reduce the capital requirement of his business. Under the United States system this man would probably have five or six hundred thousand dollars more or less permanently on his books, a large part of it being beyond his reach. He may negotiate direct loans of from $200,-

000 to $300,000, but his bank will force him to carry one-fifth of the amount at credit of his account; and he must, therefore, find his own capital for carrying the book debts, perhaps to the extent of $300,000 or more.

Branch Banks Would Revive the Bill of Exchange

Here, again, is seen how a good system of branch banks devoted to commercial banking would benefit able business men with small or moderate capital. It is quite reasonable to anticipate that once that type of branch bank became established and began to take the accounts of the merchants and manufacturers the latter would begin at once to educate their debtors to the use of the commercial bill of exchange. They would do so because of the insistence of their bankers that they be furnished with trade paper rather than accommodation bills. Instead of going forward merely as a collection bill and receiving, perhaps, contemptuous treatment at the hands of the drawee and of the correspondent bank receiving it, the instrument would be discounted at once and forwarded to a branch or to a correspondent that would accord it the respect properly belonging to it. The more general use of these instruments in the United States would unquestionably effect a vast economy of capital, and, as before said, should stimulate indirectly a healthier competition in many lines of trade and industry.

Education of the Bank's Customers

We may now understand how the manager of the Bank of Massachusetts' branch in X would begin at once to educate his manufacturing customers to draw upon their debtors and discount the drafts instead of simply sitting down and waiting for their checks. As it would require something of an economic revolution to bring about the change in practice, no doubt it would proceed

but slowly; but when the manufacturing classes got to understand thoroughly that ample credits were at their disposal on their providing trade bills, accepted or made by their debtors, they could probably be depended upon to bring the debtors into the frame of mind necessary for the acceptance of drafts.

The work connected with the large lines of credit given to the X manufacturers would necessitate an addition to the staff of the X branch. Quite probably it would now need a staff little inferior in point of numbers to that carried by the local bank. With the success of the branch thus assured, the manager, if he were wise, would play a waiting game. Unquestionably a number of citizens would be deeply impressed by the fact that the branch bank was carrying the whole accounts of those large manufacturing establishments, and by the other fact that it was open to do all the discounting business that offered. The strength and security thereby suggested would not be lost upon the depositing classes. Those impressive figures displayed day after day upon the window screens would have their certain force in attracting deposits. While perhaps the body of depositors, out of loyalty to the local institution, would leave their balances with it, the branch would get a share of the new accumulations; and there would be some clients of the older bank who would consider that the great size of the Boston bank offered them better security for their money, and they would place that consideration before everything else. Of course the savings of the workingmen employed by the manufacturing industries would have a tendency to gravitate to the bank at which the factory accounts were carried.

VII

MOVEMENT OF FUNDS TO AND FROM NEW YORK

The Extinction of the Local Banks

THAT the United States will ultimately adopt branch banking I have every confidence. At present there are only a few who desire to see it introduced; but as the people generally get a better idea of the waste and inefficiency of the present system, the impossibility of reforming it or of making its units cohere, it is to be expected that first the sentiment and afterward the laws will veer to an attitude more favorable to a different system. The chief ground on which I base this expectation is concisely expressed in an address given before the Pennsylvania Bankers' Association, at Bedford Springs, in September, 1909, by Hon. Edward B. Vreeland. Mr. Vreeland said: "I believe in this independent system of banks. I am opposed to the branch-bank system. The branch-bank system will drive any other system with which it competes out of existence. The establishment of the branch system in the United States would, in time, mean the extinction of the small independent bank. This has invariably been its history wherever put into operation. In France there are to-day only three great commercial banks outside the Bank of France. They cover the country with their branches. The thousands of local banks which formerly existed have largely passed away. The same process is going on in England. With two or three exceptions London is to-day the home of the large joint-stock banks of that country. They are rapidly ab-

sorbing the independent banks throughout England and establishing their branches in their place. **The branch system will drive out every other system because it can be operated more economically.* This is a consideration from the banking point of view, but in my judgment it would not compensate the people of the United States for the loss of the thousands of independent banks whose stock is owned in the community, whose deposits are drawn from the community, and whose interest is to assist and develop in every way the business of the community."

The Public Benefits from an Economical System

Here is the reason why branch banks are to be expected in the United States—because they are more economical. Mr. Vreeland says this is a consideration from the banking standpoint, but that it should not appeal to the general public. But surely it is the public that will reap much of the benefit if the business of banking is carried on more economically, more efficiently and intelligently, and in a manner to gain for the banks a far larger share of the confidence of the people at home and of foreign nations. He mentions the fact that France has but three great commercial banks outside the Bank of France, and that the banking control in England is rapidly passing into the hands of a few great London banks. Yet one of the things that has contributed powerfully to lessen the number of banks in France and England is the existence of a monopoly of note-issuing. In France the Bank of France has the sole right to issue bank notes; in England the Bank of England has practically a monopoly. It should be observed, in reference to the centralization of power in London, that the small area of Great Britain makes it undesirable that more than one centre should exist. For example, if Wales

* The italics are the author's.

should set up its financial centre, and the northern counties should set up theirs, it would be much the same as if each one of half a dozen sections of Massachusetts or Pennsylvania were to set up its financial centre in opposition to Boston or Philadelphia.

A Central Bank and Monopoly of Note Issue

Judging from recent utterances of its prominent members, the National Monetary Commission is not unwilling to set up in the United States that same obnoxious feature of monopoly of note issue which has been so potent in restricting banking competition in Europe. Suppose it comes about, in the course of another twenty-five years, that in the matter of disgraceful failures, and in that of humiliating behavior during panics, the independent banks of the United States make such a bad showing that the people turn generally to branch banking as a relief. If there is then in existence a great central bank with a monopoly of note issue the fact is bound to operate most importantly to reduce the usefulness of the ordinary banks, to restrict banking competition, and to prevent the supplying of good banking facilities to thousands of small places. When the branch banks begin to replace the independent banks it will be a matter of great consequence to the borrowing classes and to the people of the country districts that the branch institutions possess note-issuing rights. If the banks of any country are strong, and in every way worthy of confidence, they will be most useful to the people when they are permitted to exercise their functions freely. If a wide liberty is given to worthy institutions it is the public that will derive the greatest benefit. Because of the smallness and weakness of the independent banks, it has been necessary, in the public interest, to prevent their exercising certain functions which, properly performed, would be of service to an important part of the com-

munity. Take the business of note issue for example. I am not competent to say whether the power to issue notes to serve as currency belongs by Divine right to the Government or to the banks, but I do know that when generous rights of issue are conferred upon banks that are worthy of them, the public, especially the borrowing public, benefits directly to an enormously greater extent than it would from a jealous retention by Government of all note-issuing rights. This will be explained in detail in another place. In the mean time I shall proceed to give my views as to how branch banks may be expected to spread and develop in the United States when the time comes in which they make their appearance in force.

Each Section Will Have Its Own Banking Power

There is every probability that the development will take place along sectional lines — that is to say, the people of each of the different sections of the country will take steps to ensure that they will be served by banks identified with their own particular interests. Thus the Northwestern states will see to it that they possess banks devoting themselves mainly to financing and encouraging wheat-growing, flour-milling, lumbering, wholesale distributing, as well as the retail business and the various forms of activity in evidence in the country towns. The people of the other sections—the Pacific, the Southwest, the South, the East, and the Middle West—will also wish to have their own banks. Quite possibly there would be at first a strong tendency toward the creation of banks operating exclusively in, and belonging altogether to, the individual states. For example, a number of large banks might develop in California with head offices in San Francisco and branches throughout the state. In Minnesota and the Dakotas others might appear with head offices in St. Paul or Minneapolis and branches everywhere

through the wheat fields. Should the movement get that far it will be but a short step to branch banks operating in a whole section. From these again the transition will be easy to banks of a national character covering the whole country.

It will be objected that even if the Federal legislators were brought to permit branch banking, the state legislatures could, by means of hostile acts, prevent its spreading. The answer is that branch banks are now regarded with hostility because the people have wrong ideas as to the effects they would produce If these errors were dispelled and the sentiment became more friendly the same influence that induced Congress to look more kindly upon them would have its effect upon the attitude of many of the states.

Eastern Branches and Western Branches

In reference to banks serving a single small state, Canada's experience indicates that while they are invariably popular they may not prove so successful or so useful as others the operations of which are based on wider territory.

It has been mentioned already that in the purely agricultural districts of eastern Canada deposits have a general tendency to exceed loans. The only places in the East where loans habitually or generally exceed deposits are the large cities and such of the towns as have important manufacturing industries, or other special forms of activity. But in western Canada conditions are exactly opposite. There it is a regular thing with all banks doing a large business for loans to exceed deposits, at rural branches as well as in the cities. One reason it is so is that the farmers are extensive borrowers. From 1898 to 1900 I had charge of a rural branch in the Province of Manitoba operated by one of the important Eastern banks. Among the branch's customers were

many well-to-do farmers. Almost invariably these men were borrowers, not depositors. They saw so clearly the profit in wheat growing, and were so rapidly accumulating capital, that they re-embarked their profits at once in fresh purchases of land, equipment, buildings, etc. The 3 per cent. they could get on deposits appeared despicably small to them when considered against the profit to be made from buying, breaking, and developing fresh land. As for the business men of the town, practically all of them, from the leading merchant down to the blacksmith, were borrowers at one or other of the banks. If that banking office had been an independent entity of the United States type its ability to advance funds to the farmers and townspeople would have been cut down by at least $200,000; in other words, it could only have extended one-fifth of the accommodation which it actually provided as a branch bank.

Thus the branch banking system has been of the utmost value to western Canadian development. Because of its existence the enterprising people of that section have had access to a far larger fund of borrowable capital than they would have had under a system of local banks. Small local banks established there would never have had the credit or standing necessary to draw into their service the millions of stagnant wealth from the slow Eastern districts.

Advantage of Serving a Wide Territory

It is to be borne in mind that the business of a bank is less liable to severe depression or disturbance if it serves a variety of industries and operates in a wide territory. If for example a bank was formed and operated exclusively as a lumbermen's bank, its fortunes would rise and fall with the fortunes of the lumber industry. The same would apply to a bank involved altogether with the boot and shoe trade, or with the dry goods trade, or any other of the great trades and industries. In any of those

cases the eggs would all be in one basket. So with a bank restricting its operations to a particular district. Everybody knows that when depression comes it settles on some districts or localities with especial severity. Within certain boundaries, owing to the failure of a crop or to some other unfortunate circumstance, all is black and gloomy; outside, conditions are not so bad, and perhaps a short distance away everything is progressing satisfactorily. A branch bank, scientifically constituted, will aim to have its operations cover a wide variety of territory and a wide variety of interests and activities. Most of the large Canadian banks cover the Dominion very completely, and a depression must be general in character to affect their fortunes appreciably.

Branch Banks and the Wheat Crop

We may now consider the practical working of a system of branch banks in financing the crops. This is one of the tasks in the handling of which the isolated local banks are notoriously deficient. To make the comparison more effective two descriptions will be given—the first outlining the financing of the crops under the present system; the second outlining the financing as it would be done under a branch system similar to the Canadian. It will be most convenient to take the spring wheat crop of the Northwest as the example, and the operation of handling it will be taken from the beginning of the harvest to the close of the season in the following spring.

Under the present system all banks operating in the wheat fields must prepare during the summer for crop moving. The officers of each individual institution know that with the coming of August and September they will be subjected to heavy extraordinary demands for currency. Buyers of wheat must have cash to pay the farmers at all points where wheat is delivered. This cash they look to the local banks to provide. These demands

must be met. The local banks in Minnesota and Dakota recognize that as soon as the threshing season is inaugurated they must be ready to supply the demands of their customers for circulating medium. Part of this demand comes upon them in the form of a withdrawal of deposits, part in the form of a demand for loans, and part in the form of a demand for cash in return for New York or Chicago exchange. As the season develops, the proportion represented by the loans tends to get relatively larger. Looking at the matter in its largest sense, and supposing the Northwest required $50,000,000 of extra currency during the fall to move its wheat crop, the banks there must be prepared to hand out that much of extra money during those three or four months.

Evils of a Rigid Currency

During the rest of the year, comprising eight or nine months, no employment for the funds offers itself in their own district—that is, no suitable employment. If the Northwestern banks, in January and thereafter, when they have finished the earlier stages of moving the crops, followed the course of trying to use in their ordinary loans and discounts that part of the $50,000,000 of extra currency which had done its work and was back again on their hands, their action would produce some serious evils. They might not be able to find proper investment for it, but assuming that they were successful in placing it among their local borrowers, there would remain the necessity of recalling it from the parties who had it as soon as the next crop was ready for harvesting. Persons familiar with the banking business will understand that this could not be done; for the parties enjoying the benefit of the loans would not willingly relinquish them. To force them to do so would cause great hardship and dislocation of trade. Therefore that policy is not followed except perhaps by inexperienced bankers.

During the off season the fund must be in reserve. There probably will be opportunity to put out a certain amount during the spring and summer in loans required to finance operations to be completed before the harvest begins; the borrowers in this case would make repayment of their own accord not later than July or August. But only a small part of the whole fund could be used in that manner. The bulk of it must either be carried as cash in vault and lie idle for the greater part of the year, or else sent away to a market or a centre which will pay something for the use of it, and be ready and able to relinquish it on demand or on a date fixed to fall before the harvest begins. Such a market exists in New York City. Some of the other cities have risen rapidly in financial importance, but none of them can offer the advantages which New York offers. This statement holds good so long as New York is the financial heart of the country. It may be supposed by some bankers anxious to build up Chicago, St. Louis, Kansas City, etc., that their reserve money is just as good in those centres as in New York. It would be just as good if the reserve agents selected held the whole of it as cash in vault against the day of withdrawal, but that they do not do. They could not afford to pay interest on it if they did. To put their funds in use, and at the same time have them so that they can surely be recalled at will, is what the bankers require. There is no place in America as suitable as New York for this purpose. Banks in other cities may be as strong and as solid as the New York institutions, but there is no place in America where, speaking generally, call loans on stocks and bonds are equal to the New York call loans in point of immediate availability.

Rival Financial Centres

I have seen it argued from time to time that if other centres, such as Chicago and St. Louis, kept their reserve

money at home, and if the citizens of those places would do their speculating at home instead of buying and selling in New York, their home stock-markets would be broader and better, and New York would not overshadow them to such an extent as is now the case. But the fact is that no matter where a man lives, if he has any intelligence at all, when he undertakes a speculation or deal in stocks he will always see to it that the circumstances connected with his deal are as favorable to himself as he can, in honor, make them. One thing every sensible man will try to do. He will try to buy or sell in the best market. That is why he goes to New York to deal in stocks. Dealing in Wall Street, if he wishes to buy, he knows he will find sellers from his own city like himself dealing in the best market, sellers from New York City, sellers from London, Paris, Berlin, and from Europe in general, sellers from the other parts of the United States, from Canada, Mexico, and South America. And if he wishes to sell there will be buyers from the rest of the world to bargain with. This advantage—of operating in the best market—he will not forego for all his local feeling. Patriotism even does not induce him to relinquish it. For if there is a certain stock which may be bought better in London than in New York, the New Yorker will cable his order to the other side of the Atlantic.

That is one reason why New York is the best centre for reserve money. Another is that call loans there may be called when funds are wanted. One of the most prominent Chicago bankers recently said, in reference to the matter of call loans, "We have call loans in Chicago, but if we were to call them it would make us very unpopular."

New York the Best Centre

So a large part of the $50,000,000 released from service in the Northwest goes to New York during the spring and summer. It will probably happen that many banks in

the Northwest send their shipments of currency to, and carry their balances in, banks in Minneapolis, St. Paul, Chicago, and St. Louis; but it is certain that these banks in turn will send a part of the money on to New York either as balances in reserve banks there or as call loans to New York stock-brokers.

There may not be any work awaiting this currency on its arrival at the metropolis. It swells the bank surpluses, and its presence is quickly noted by the speculating cliques. Quite frequently its coming is marked by a lowering or reduction of interest rates. When this happens the combination of the two circumstances — abundance of available credits and cheap rates of interest— may prove too great a temptation for the cliques to resist. They are induced to inaugurate bull movements with the idea of unloading on the unwary at top prices, sometimes when conditions do not warrant any advancement of the price level.

At any rate, the fund goes largely into call loans to New York Stock Exchange houses. About August the Northwestern banks begin to prepare for the autumn demands. They start withdrawing their balances from New York, and calling in their loans there, asking that the proceeds be shipped in the form of currency, so much per day or so much per week, so as to make the movement conform approximately to their requirements.

I am aware that large banks in Chicago finance some of the more important grain-buying and flour-milling concerns in the Northwest in the same way as the large Boston banks finance important cotton mills in the Southern states. The fact does not materially affect the argument I am now presenting; and, as remarked before, the practice is an argument for branch banking, inasmuch as if these Southern cotton mills and the Northwestern grain and milling concerns must depend on loans from Boston and Chicago banks it would be better for both borrowers and lenders if the banks could establish

branches at the points where their important borrowers operated.

Recalling the New York Balances

To resume the narrative—in Minnesota and the Dakotas the country banks are being asked to relinquish deposits and to make loans to parties connected directly or indirectly with the grain trade, or whose business operations are affected by the movement of wheat to market. In the wheat districts, as the currency goes into employment, the amount in the hands of farmers, grain dealers, storekeepers, gets larger and larger, while the wheat streams into the country elevators on its way to the terminals and ports. By-and-by the interior banks have all their resources in play, and some of them borrow from the city banks so as to be able to support their customers. Each bank's ability to lend to the people in its constituency depends upon the condition of its resources. If the local bank has a large proportion of liquid resources—cash, and call loans and balances in New York—it can lend extensively at harvest time. But if its resources are already fully employed when the harvest commences, it cannot lend further assistance except through borrowing or rediscounting.

In New York the banks may, at first, respond to the calls from the interior without disturbing their loans on stock market collateral; but, as their reserves fall nearer to the legal minimum, they usually are obliged to call in their loans, and, likely as not, stringency will develop.

Supply of Currency Not Regulated by Demand

Taking the whole business broadly, it is to be seen that this special commercial use for the $50,000,000 currency exists only about three and a half months in each year. So that if the supply of currency in the United States at

harvest time is exactly equal to the requirements, then, after the work is done, there is a surplus of $50,000,000 for which no legitimate work offers. And if it be assumed that there is in the country an amount of currency exactly sufficient for the requirements during the rest of the year, then it follows that the extra need of the harvest time will create stringency because the supply is deficient.

Let us next picture the financing of the Northwestern wheat crops under a system of branch banks. Suppose that we are watching the operations of a great bank—which we may designate the Bank of Minnesota—with head office in Minneapolis and branches scattered everywhere in the wheat fields, as well as in New York, Chicago, and in smaller places in the East. It will be assumed also that this hypothetical Bank of Minnesota, in common with the other branch banks operating throughout the country, has note-issuing privileges similar in character to those possessed by the chartered banks of Canada.

VIII

ANOTHER HYPOTHETICAL BRANCH BANK

The Bank of Minnesota

THOUGH the principal aim of this bank is to finance Western or Northwestern development, it has found it advisable to acquire large interests in other parts of the country. Thus it has established branches in some depositing districts of the East with the object of getting money for Western borrowers. How this may be done without injury to the Eastern localities has already been explained. Then the close identification of Chicago with the wheat business, and the concentration there of houses and institutions dealing directly with the Northwest, have made it advisable to maintain an important branch in Chicago. Also, like the other large branch banks, regardless of where their head offices are located, the Bank of Minnesota maintains a branch in New York City. Because of the nature of the business done by it, and because of the magnitude of its operations, this New York City branch ranks practically equal in importance with the main branch in Minneapolis, which is directly under the supervision of the head office executive.

Functions of the New York City Branch

First, the New York City branch acts as New York correspondent for all the branches of the bank. When the branches acquire New York checks, drafts, or exchange,

instead of sending them to some great New York City bank for credit of account, as is done by all the isolated country banks at present, they send them to their own New York branch. Also, whenever they issue drafts on New York, they draw on the branch, not on an outside institution.

Second, the New York branch acts as custodian of a large part of the reserve carried in actual cash. It is to be remembered that there are several other Western or Northwestern banks operating in the wheat fields; also that some large banks with head offices in Eastern cities have branch systems in that section of the country. It will happen that in Minneapolis and St. Paul are represented, perhaps, three dozen or more important banks. Each one has its principal branch for the district in the heart of the financial part of one or other of the two cities. From these centres scores of auxiliary branches radiate through the outlying sections of the cities and through the whole wheat country. Thus it would happen that in an interior town of twenty-five thousand inhabitants, if it were a good centre, there might be a dozen or fifteen banks represented—both Eastern and Western institutions—and in a smaller place of ten thousand population there might be eight or ten. In each of the little villages of three hundred or four hundred people there would surely be one bank, and if there existed a reasonable prospect of the place growing satisfactorily very likely there would be two. The villages and towns with populations between three hundred and five thousand would have from two banks to half a dozen, according to the amount of business they supplied.

Exchanges at the Lesser Branches

At these lesser points, under the branch system which is being pictured, the banks, of course, would have a daily exchange of checks and notes. They would not,

however, settle differences in cash. Settlement would be by draft on whatever centre the respective parties agreed upon. Thus, probably, it would be agreed in many instances to settle by draft on Minneapolis or St. Paul; and in others by draft on Chicago or New York. The settling centres would be exactly as the various reserve centres are now. So it would not be necessary to carry large legals for clearing-house or settlement purposes at any of the country offices. Each branch might carry a few large notes for meeting the demands of individual customers, should it have customers in the habit of demanding them. Apart from these, practically the whole stock of legals and most of the specie would be concentrated at the central branches. Though the country branches throughout Minnesota and the Dakotas might draw on Minneapolis or St. Paul when settling differences with other banks, the Minneapolis and St. Paul offices, even of the purely Western banks, would find in actual practice that it was advantageous for them to carry a large part of their specie and legals in New York City.

The Reserve Against Deposits

The Bank of Minnesota, for example, would find that many of its customers on getting loans from it would require to have the proceeds paid to parties in New York. Also that the depositors, or many of them, in making withdrawals would do so through the New York branch. And all the time there would be trafficking in New York exchange by the banks in the twin cities. For buying and selling sterling and foreign exchange New York would be largely used. Purchases and sales of securities, too, would take place there. So it would be necessary to carry a large balance of specie and legals in the metropolis. But the reserve would not, by any means, consist entirely of specie and legals. Specie and legals would constitute the first line of defence. Behind them would

come the balances in great international banks and the call loans in the great international markets. While the Bank of Minnesota need not necessarily carry a large account or balance with another bank in New York City, it certainly would carry a balance in London and, perhaps, also in Paris. The Bank of England or one of the great British joint-stock banks would be its London bankers. Perhaps it would, like the Canadian banks, deposit several million dollars' worth of bonds having an international market with its London bankers to be used as cover for drawings.

After the international bank balances would come the call loans. These, if they formed an integral part of the reserve against deposits, must necessarily be at New York or London or Paris. Call loans on stocks and bonds at other cities in the United States, for the reason explained in the previous chapter, though they may be safe enough and sure enough of repayment, cannot equal call loans at the international centres in the quality of instantaneously producing specie and legals on demand.

Lessening of New York's Control

Let us here take note of one significant economic change that would occur as a result of a change in the character of the banks. Suppose the Bank of Minnesota has $12,000,000 at call in Wall Street — the fund forming part of its reserve against deposits. This money is controlled from Minneapolis — absolutely. It is put out solely for the convenience and profit of the Bank of Minnesota. If the bank's stock of specie and legals accumulates through the increase of deposits or the repayment of loans in the ordinary course of its business, the branch in New York will put out some more millions at call. If, on the other hand, the specie and legals fall, through the withdrawal of deposits or the making of loans, some part of the $12,000,000 is called in. There can be no

suspicion, in this case, of manipulation of the money or stock markets for the benefit of capitalists or financiers in New York.

An instructive comparison may be instituted by supposing that the Bank of Minnesota has one hundred and fifty branches, that the total of its international bank balances, its specie and legals, and its call loans carried in New York is $30,000,000; and by supposing secondly that at present one hundred and fifty isolated banks in the Northwest and the East, the operations of which would correspond to those of the hypothetical Bank of Minnesota and its branches, carry the same amount of $30,000,000 in the form of call loans and balances in New York. Under the present system the fund of $30,000,000 has one hundred and fifty owners. They send the cash to various great banks in New York City, which take it on deposit and use it as their own money, or lend it for the account of their correspondents. A number of the most important New York depository banks are understood to be hand and glove with those powerful market interests of which the rest of the country professes to be much afraid. These interests thus have, at present, the practical control of perhaps a third, perhaps a half, and perhaps two-thirds of the whole fund of $30,000,000 here referred to; while under the branch system, if those one hundred and fifty banks comprised the Bank of Minnesota, they would not control a dollar of the money. This is one way in which the control of those metropolitan financiers over the cash resources of the country might be weakened through the institution of branch banks.

The Bank of Minnesota in a Panic

Take the change in another way: Suppose a panic is in progress. Quite probably one hundred out of the one hundred and fifty isolated banks controlling the $30,-

000,000 of funds in New York would demand the immediate return of perhaps one-half of their balances and loans, merely as a precaution, when they were not in any danger at all. New York is thus legally under the necessity of surrendering these millions at a time in which it sorely needs every dollar. If the same funds were controlled by the Bank of Minnesota, how differently they would be handled. The panic breaks in New York —probably an important bank suspends and stocks crash downward. The manager of the New York branch, who is a thoroughly competent and trustworthy official, keeps the head office informed hourly as to the situation. He does not need to explain at the outset that the bank is not involved in the failure through lock-up of its balance, for it keeps no balance in New York banks. It may, perhaps, have $300,000 or $400,000 or more in checks and exchanges for the failed bank, but the greater part of this sum can be at once recovered through charging back the items to the customers from whom they were received. So there is no danger of balances being locked up. The New York specie and legals are safe, because they lie securely in the Bank of Minnesota's own vaults. There only remain the call loans. These have been made to Stock Exchange borrowers of the highest standing strictly on securities possessing a good market. That is the kind of loans that are made by the Canadian banks in New York, and it would be the same with good American branch banks like the Bank of Minnesota. In making them the New York manager kept in view the fact that they must be surely available on demand. He was not concerned in making a market for any particular stock or stocks, or in market movements of any kind. Consequently, when the panic developed he could assure his head office that the call loans were all right, and that there need be no uneasiness in regard to them. He would be exceedingly careful to see that every borrower kept up his margin, and the standing of the borrowers

being of the best, they would certainly respond at once to demands for margin. So he could assure the head-office people that so far as New York was concerned they might proceed with their business as usual.

A Factor in Preserving Stability

Probably it would happen that the committee or association of bankers and financiers in New York that was engaged most actively in fighting the panic would find it necessary at an early stage of the crisis to support one or more important banking institutions or business houses that were threatened with insolvency. Should that be the case the Bank of Minnesota—of course under authority from Minneapolis—would take its part with other banks in preserving stability. It could, without undue danger to itself, advance its quota of several millions to the general fund for this purpose. The public announcement of its name as one of the banks lending assistance would strengthen its own credit and reassure its own depositors.

Out in the Northwest the people would hardly be aware that there was a panic. The various branches of the bank would have little concern in the matter. So they proceed with their regular operations very much as usual. They draw on Minneapolis, St. Paul, Chicago, New York, in the accustomed manner. Their drafts are honored, as before, in specie and legals. Great banks like these, intently concerned in building up a spotless reputation for themselves, will not consent to anything so dishonorable as a suspension of payments except in the gravest emergency. That emergency is not so likely to occur if the country banks refrain from withdrawing cash from the centres and hoarding it.

The Country Branches Continue Discounting

The country offices of the Bank of Minnesota continue to give the customary support to their regular borrowers. In

deference to the panic and to the stringency in money the executive will have sent round instructions to the branches requiring the managers to abstain from committing the bank to advances for new enterprises or new connections, also to hold their borrowers in check, restraining them from going into extensions and from taking up new ventures. In all probability this policy would be instituted before the panic developed. With these limitations business goes on as usual. Storekeepers and factory owners, farmers, dealers, and others, who have been wise enough to keep their indebtedness well in hand, lodge their bills and notes with the bank as usual; the bank discounts them, proceeds are put to credit of the borrowers' accounts, checks are drawn against balances and are paid in cash without demur.

If a different course were followed, and the bank, falling into a panic itself, began savagely to call its loans in New York, and to collect all the specie and legals it could lay hands upon, and if the executives sent orders to the branches to stop discounting even for regular customers and to exact payment of all notes and bills as they came due, what a different state of affairs would exist. Such a policy generally followed would precipitate Stock Exchange and other failures and the bad effects of the panic would be intensified.

Security of the Note Issues

The reader will have derived from the foregoing explanation a partial knowledge of the business carried on by the Bank of Minnesota. Before describing its method of financing the spring wheat crop of the Northwest it will be well to describe the note-issuing powers with which it should be endowed. It may be said that the note issues of the Canadian chartered banks are believed by the experts to be absolutely secure. Besides the priority of claim upon the assets and the practical guar-

anty of the associated banks, the bank notes are protected by the Bank Circulation Redemption Fund held by the Minister of Finance and Receiver General of Canada. This fund is the property of the banks contributing it, but liable to be used for paying the notes of a failed bank, providing the liquidator does not do so within sixty days from the date of suspension. Each bank must keep in the fund a balance equal to 5 per cent. of its note circulation as that averages through the year up to the preceding 30th June. The total of the fund, therefore, amounts roughly to 5 per cent. of the whole average circulation. Essentially the security behind the notes is not the fund but the first lien on the assets and the guaranty of the associated banks. If the fund is depleted the banks may be called upon to restore the balance—up to the 5 per cent. required—but not at a greater rate than 1 per cent. of their average circulation per year. The first lien provision and the necessity to provide 5 per cent. for the redemption fund apply to the extraordinary issues as well as to the ordinary.

Economy of Cash Capital

We may suppose that the Bank of Minnesota has a paid-up capital of $12,000,000, and that it has the right to issue its own notes, uncovered by specific security and free from tax, up to that amount. We may suppose further that its circulation runs, during the summer months preceding the harvest season, at $6,000,000. At the commencement of the grain deliveries it would, therefore, be in position to supply roughly $6,000,000 in currency for crop moving purposes. But this bank is only one of a considerable number actively operating in the Northwest. Taken altogether these banks could probably supply $125,000,000 or $150,000,000 in new currency if it were required. However, as the Bank of Minnesota is one of the local Northwestern banks, with directors, stockholders, and friends closely identified with the grain

trade, it is able to find a use for the whole of its $6,000,000 margin. Let us now follow its operations.

To maintain its circulation of $6,000,000 in quiet times, and of $11,000,000 or so in harvest time, the bank must possess probably $5,000,000 or $6,000,000 in notes, signed and ready for issue, over and above the amount actually in circulation. This is necessary because all the branches must have a sufficiency of till money. At the smaller country branches perhaps an average of $15,000 or $20,000 per branch would be required all the time regardless of the amount outstanding. And the depot branches, or centrally situated branches, would need to carry much larger sums. Altogether, probably $40,000 per branch would not be too high an estimate of the reserve supply of notes required to be carried. If the branches are taken to number one hundred and fifty this requirement comes out at $6,000,000.

The Cost of Providing Currency

So, during the summer, the head office would arrange for a supply of notes sufficient to replace worn notes and to make the balance of good notes on hand and in circulation up to about $18,000,000. If the amount outstanding was $6,000,000 there would be $12,000,000 on hand available for issue and for till money. This $12,000,000 in the bank's own notes might consist of $4,000,000 in fives, $5,000,000 in tens, and $3,000,000 in twenties, fifties, and hundreds. In other words, the specification of its own notes held by the bank might read as follows:

800,000	×	$ 5.	=	$4,000,000
500,000	×	10.	=	5,000,000
50,000	×	20.	=	1,000,000
20,000	×	50.	=	1,000,000
10,000	×	100.	=	1,000,000
1,380,000				$12,000,000

Over and above the cost of the plates, if the cost of each note be set at 2½ cents, the bank would need to make an outlay in cash of only $31,050 in order to provide itself with this potential currency amounting to $12,000,000, of which $6,000,000 might be issued and $6,000,000 held as till money. It may also have been obliged to deposit $450,000 in the general redemption fund. Thus at the outset the difference in methods of preparing for the crops is seen. The Bank of Minnesota has ready to pay out $6,000,000 of currency, and has only parted with $481,050 of its cash resources to get it. Under the present system that aggregation of one hundred and fifty banking offices could not prepare $6,000,000 in currency without engaging a full $6,000,000 of their resources. To whatever extent they augment their store of circulating medium in the late summer, they must draw upon resources that have been employed in some other way.

Lending to the Grain Trade

In the summer, some little while before the first delivery of grain will take place, the various grain-buying and milling firms, and companies that have accounts with the bank and its branches, would arrange for their lines of credit. A few of these concerns may transact so large a business and require such heavy advances that two or three large banks may unite to carry each account. The several banks combining to carry an account of this kind would agree among themselves as to the proportion to be assumed by each. Accounts requiring credits not greater than $1,000,000, or $1,500,000, or perhaps in some cases $2,000,000, would be carried by one bank. It has already been remarked that the directors, stockholders, and close connections of the Bank of Minnesota include some men influential in the Northwestern grain trade. Therefore, the bank is certain to have its share of good grain and

milling accounts. It will have a number which deal exclusively with it; and it will also participate in carrying some of the best of the larger divided accounts. Six weeks or a month before the crop is ready for marketing, the general manager and the board of directors will have completed their work of considering and acting upon the credits asked for by all these customers. At the principal branch in Minneapolis (that under the shadow of, and in the same building as, the executive offices), and at all the branches throughout the wheat country, the managers and officers have been informed of the amounts they are authorized to lend to each important customer, the rate of interest which the loan shall bear, the security on which it is to be based, and the other terms and conditions on which it is to be made. Also, as we have seen, the currency is ready for paying out—not a dollar having been withdrawn from use either in the Northwest or any other part of the country.

But though it has not been necessary to call loans in order to provide a sufficiency of the bank note currency, the bank may have found it advisable to reduce its New York call loans to a moderate extent in view of the heavy advances it has agreed to make to Northwestern interests.

When Wheat Deliveries Commence

The machinery is ready, waiting for the call to work. The wheels are set in motion by the appearance of new wheat in the market at some of the small country towns. Buyers there for local millers or dealers, and for Minneapolis concerns, wire to their principals that deliveries will commence next day and ask for a supply of cash. Immediately the bank credits are used. Local dealers at the points in question appear at the local branches of the bank, put in their credit obligations, and borrow under the terms of their arrangements. It may be that some of the dealers are able to take the wheat and give in

exchange orders or checks on the local branch, thus economizing the use of cash. Whether this is done, or whether the buyers draw bank notes from the bank and pay them out for the grain delivered, the effect is the same—the bank's note circulation is moving out, and at the same time the aggregate of its grain loans is rising. Either through paying out the notes themselves to the grain firms, or through paying them out against checks given to the farmers by the grain buyers, the notes go out largely as the proceeds of loans. It may be that the bank has contracted with the grain trade to advance in the aggregate $11,000,000 and that grain loans to that amount are actually current at the time the note circulation is at the maximum. If it were possible to analyze these loans, and to discover in what form they had been made, it would, perhaps, be seen that some $5,000,000 of the proceeds of loans had been paid over in the form of the bank's own notes, that $2,000,000 had been paid in specie and legals, that $2,000,000 had been advanced through giving credit on the books as new deposits for account of farmers and others, and that $2,000,000 of proceeds had been applied voluntarily to the repayment of existing loans.

The Profit in the Note Circulation

This illustration shows clearly how the people of the Northwest benefit from the note-issuing powers of the Bank of Minnesota. There are plenty of people in the United States who believe that a right of issue, such as that described, is nothing more than a tremendous profit-making opportunity for the banks. They regard the right to issue notes to serve as currency as something belonging naturally to the Government, and they think the Government is entitled to all the profit therefrom. As I said before, I do not aspire to settle the question as to where this right belongs, but it seems to me abun-

dantly clear that when the currency is provided by strong commercial banks of the character of the hypothetical Bank of Minnesota, the mercantile interests of the country benefit to a much larger extent than they could hope to benefit under a system wherein the currency was supplied by the Government. I concede that the Bank of Minnesota makes a satisfactory profit through its ability to pay its own notes into general circulation up to a maximum of $12,000,000; but it yet remains true that the borrowing customers of the bank reap a considerable gain from its exercise of this franchise. What the bank gains may be summed up as follows:

Assuming that its average circulation for the year is $9,000,000, that might be disposed in this way:

Five per cent. deposit in the Redemption Fund......	$ 450,000
Twenty per cent. reserve carried in cash..............	1,800,000
Ten per cent. reserve carried as call loans	900,000
Five per cent. reserve carried as bank balances........	450,000
Sixty per cent. carried as mercantile discounts........	5,400,000
	$9,000,000

The annual revenue derived therefrom might be:

On the balance in Redemption Fund at 2 per cent......	$ 9,000
On cash..	nil
On call loans at 2½ per cent.........................	22,500
On international bank balances......................	nil
On mercantile discounts, 5 per cent..................	270,000
	$301,500

The annual charges against this gross income might be:

Plates and printing new notes........................	$ 20,000
Express and other charges pertaining to distribution of notes, and redemption of other banks' notes received over the counter..............................	52,000
Clerk hire and other expenses attributable to note circulation	87,000
	$159,000

The net gain on the notes in circulation might thus be $142,500. To it should be added the saving of interest

on that portion of the till money carried in the form of the bank's own notes. This might amount to another $80,000, making the gross gain to the bank $222,500, or 2.47 per cent. on its average outstanding issues.

How the Borrowers Benefit

Next let us see how the commercial community in the Northwest benefits from the exercise of note-issuing functions by the Bank of Minnesota. We have seen that the bank makes about half of its total advances to the grain trade in the form of its own notes. So it is quite plain that if it were shorn of its issue rights its ability to extend accommodation to its customers during the grain season would be seriously curtailed. If it is presumed that its advances of $2,000,000 in specie and legals represented all that it was prepared to advance in that form, and that it was not possible to increase the proportion of $4,000,000 advanced through book credits given to farmers and others, it follows necessarily that at the beginning of the season the bank could only undertake to grant credits to the grain trade for $6,000,000 instead of the $11,000,000 which it readily undertakes when possessing its issue powers.

Possibly it would be quite safe to apply this reasoning to Canada, and to say that because of their extensive issue rights the ability of the chartered banks to lend to the grain trade is practically doubled. What this means to the trade and to business men generally may be easily imagined. They get their accommodation with much less trouble, and they pay less for it. In other words, they are able to finance a larger business at a lower expense ratio. There is reason to believe that the interest rate in Minneapolis would be quite ¾ per cent. lower under a system of this kind. In the smaller country places throughout the Northwest it ought to be fully 1 per cent. or 1½ per cent. lower. Taking it at ¾ per

cent., and applying that to an aggregate of $100,000,000 of grain loans, running for six months, the annual saving would amount to $375,000 in this one item alone, to say nothing of the extra profits to be made by the grain men and merchants through their ability to get larger credits without unnecessary bother. It is to be remembered that the saving in interest here referred to results merely from the expansive circulating power coming into use in the fall and early winter. A much larger saving in interest and a larger opportunity for profit-making by the mercantile public would attach to the steady use by the banks of their note-circulating powers through the rest of the year. Unless I am altogether astray in my reasoning it certainly would be an unwise proceeding to give a monopoly of note issue to a central bank, thus blocking the way for giving to the ordinary banks at some time in the future rights of issue which would be of inestimable value to their borrowing customers.

Absorbing Small Local Banks

It is to be remembered that the Bank of Minnesota was formed originally by a combination of banks operating in the Northwest. Its directors are prominent business men of the twin cities, and it has followed a policy of absorbing other banks, and of opening branches in many places that had no banking facilities prior to its coming. It will be interesting to note some of the principal differences that would strike the banker of a Northwestern country town or village on the occasion of the absorption of his local bank by the Minneapolis institution. Unless there was some good reason for dispensing with his services he would, of course, be retained as manager of the branch.

On the transformation of his local bank into a branch of the Bank of Minnesota the country banker in the Northwest would first be struck with the fact of the removal of the hard and fast limit to the gross amount

of his loans and discounts. While doing business in the independent way he always had to keep an eye on this limit. To do so will be no longer necessary. All he need do now is to convince the general manager in Minneapolis that the loans he proposes to make are sound and desirable; and when he does that it will not matter if the balance of his loans and discounts rises to double the highest figure ever reached while the bank was operated as an isolated unit.

Effects of the Change of Form

Next the banker would find, as I remarked in Chapter IV, that he was relieved from the whole load of worry and care about the reserve against liabilities.

Thirdly, he would notice that the bank inspired a greater respect than formerly among the customers and townspeople.

The townspeople and farmers would also be struck with some important changes. So far as the borrowers were concerned, they would find that when they were able to give the required security they might borrow anything in reason at rates nearly as low as those paid by the best merchants in the cities. (In my experience I have known small country towns in Canada where the leading merchants had a discount rate fully as low as that paid by the directors of the bank, and these country customers, though their business was small, actually had better terms, from the bank, in the way of commissions charged by it for its services, than the directors enjoyed. This peculiar state of affairs results from the keen competition prevailing at branch points.)

Local Borrowers and the Head Office

I concede that in one respect the metamorphosis into a branch might result, on certain occasions, in inconveniencing those borrowers who experience a sudden need for a bank loan to carry through a transaction presenting

itself unexpectedly to them. Dealing with a purely local bank a borrower of this kind might present his application or request and have it acted upon the same day. If it proved impracticable to convene a meeting of the board to authorize the advance, one or two of the principal directors could probably be seen and a tacit authorization secured. With the branch bank, on the other hand, the manager would not have the requisite authority for granting the credit if the amount exceeded a very moderate sum. It would be necessary to refer the transaction to the head office and possibly several days, perhaps weeks, might elapse before the credit would be available. Besides subjecting him to inconvenience this delay might deprive the customer of the opportunity of undertaking the transaction and cause him to miss what he considered was a sure or certain profit.

But, conceding that in this respect the change would be disliked by a number of people, it can, nevertheless, be said that in actual practice the passing from the locality of the credit-granting power would be attended by less inconvenience and trouble than might be supposed. There would be, though, a real difference in the position of those local parties who had been getting, under the old régime, specially good treatment by reason of their political, social, or religious connection with the local directors or officers. Under the branch system their applications would be passed upon, not sympathetically by political partisans or brother churchmen, but by cold financial experts who invariably demanded to be shown a record of cleanness and square dealing, of reasonable ability in business, and of a necessary surplus of merchantable assets over floating liabilities before allowing credits.

Local Manager Has Strong Influence

So far as those borrowers are concerned who are accustomed to stand upon their own feet, the change, even in

the case of unexpected occasional transactions like the one referred to, need not be awkward nor inconvenient. True, the branch manager is fettered, in a sense, and he has not the credit-granting power except for small sums; but if he is a good man he will have a powerful voice at the head office, and to get his approval of a loan would be a long step toward getting it authorized by the head office. It should be borne in mind, also, that all business men conducting enterprises of any magnitude would be encouraged, under the branch system, to arrange at the beginning of each season or year for a line of credit to continue in force during the whole season or year. It would be quite easy for all parties having the requisite standing and credit to make timely provision, when arranging these credits, for the handling of such special deals or transactions as might present themselves unexpectedly in the course of the season. And of course, if the deals are provided for in the credits, all that is necessary when the occasion presents itself is to go to the branch and hand in the note or notes representing the sum required. This process is more expeditious even than that which is usually followed under the present system whereby the local directors are gathered or seen and their consent to a special loan gained.

And, even when an experience of the kind suddenly happens to a borrower in good credit who has not provided for it in his regular credit, it does not necessarily mean that he cannot get prompt action when dealing with the branch bank. The transaction may be arranged in an hour by means of the telegraph. Or it may happen that the branch manager is strong enough with the head office, sure enough of the borrower's position and responsibility, to give him the credit without waiting for the executive sanction, or in confident knowledge that the advance will be authorized as a matter of course on its being presented to the general manager.

Local Interests Would Be Respected

It is nearly always assumed by the opponents of branch banks that local borrowers would prefer altogether to negotiate for their banking accommodation with banks owned and operated by local people rather than with banks owned by a body of stockholders mostly living in other places and managed by officers resident in a distant centre. In dealing with this assumption I would point out that in most towns there are a number of local borrowers who would be very glad to have the opportunity of transacting business with a bank of undoubted strength which was not at all involved in the local politics. For example, there might be a number of the small traders who dislike having their inmost financial affairs passed upon by local parties some of whom might be hard competitors in a business way. A small retailer would hardly be disposed to apply for credit at, and place himself in the power of, a bank on the board of which, perhaps, a dominating place was occupied by a local departmental store proprietor whom he believed to be trying to crush him. People holding these views—and they would be found chiefly among the smaller tradesmen—would be more comfortable and more disposed to use the bank's facilities if their financial business was looked after and their secrets guarded by a professional owing no allegiance to, and free from the influence of, all local parties and interests.

IX

WALL STREET DOMINATION

Other Hypothetical Branch Banks

IT will hardly be necessary to describe at length the operations of other hypothetical branch banks which, while being of the same type as the Bank of Massachusetts and the Bank of Minnesota, would serve different parts of the country. I might describe the operations of a Bank of Georgia, devoting a large share of its attention to the production, marketing, and manufacture of cotton; of a Southwestern Bank, heartily engaged in aiding the people of the Southwestern states in the carrying on of various lines of industry and trade prevalent in that section of the country; of a Bank of Illinois, with head office in Chicago and branches scattered profusely in the Middle West; of a Bank of Virginia, a Bank of California, and so on. For titles the different states, the great cities, the various industries and trades, the names of historic or wealthy individuals and families, would furnish some excellent material. It should be borne in mind that a so-called Bank of Illinois would have no monopoly of the business in that great state; it would be called upon to meet the competition of dozens of other banks of the same kind as itself. Possibly it would not be able to count upon having a monopoly of business at any point or place in Illinois or elsewhere, except in those very small villages in which it had established itself before any competitors appeared, and which furnished a bare subsistence for but one bank.

Attitude of the State Legislatures

Perhaps it will be argued that the legislators of certain of the states, even if they do ultimately bring themselves to permit branch banks to operate within the state borders, will be disposed to prohibit or to interpose obstacles in the way of the establishment within their state of branches of banks belonging to other states, or to other sections of the country, with the notion that the interests of the state will be best served by banks of its own creation and owned by its own citizens. But a moment's consideration will show that this notion is entirely erroneous. Should any state follow that policy it would, of course, benefit the local banks in some ways. They would be shielded from some strong outside competition, and perhaps they could maintain their lending rates at a higher level. However, it is clear that the benefit which the local banks gained in that way would be largely at the expense of the business people of their own state. It would be in the interest of every merchant, manufacturer, farmer, and every individual or company having use for bank loans, and in the interest of all who owned funds available for depositing, that there be in the state as large a representation of strong banking institutions as the state could attract. The more banks there were from outside states the keener would the competition be, the better would be the terms on which the business men could borrow, and the more completely would the rural districts be covered with banking offices.

Evolution of Two Canadian Local Banks

There is an interesting feature of the development of the branch system in Canada which bears directly on this phase of the subject. Among the large institutions of the Dominion are two banks which were founded and originally owned in the Province of Nova Scotia. At an

early stage in their careers both had extended their operations into the neighboring Province of New Brunswick. Until toward the end of the last century, however, their operations in Canada were mostly confined to the two maritime provinces mentioned. About ten years ago both broke into Ontario and Quebec through opening branches in Toronto and Montreal. This move they followed by establishing branches at other points in those two provinces; and one of them began some time ago to push its branch system into British Columbia and western Canada. The entry of the other into western Canada occurred more recently—though it should be said that it had a branch in Winnipeg in the early "eighties," but withdrew from that field as a result of losses suffered in the collapse of the Manitoba land boom in 1884. These banks have not confined their attention to Canada. Both are in Newfoundland and in the West Indies, where they transact a large and profitable business. Finally each has its agency in New York City, and one has a branch in London. After the movement of expansion had been under way for a time, both banks found Halifax unsuitable and inconvenient as a head office. So one selected Montreal, the other Toronto, as the home for the executive management.

Institutions of National Importance

Starting as a sectional or provincial concern, each of these banks has enlarged its scope and its territory, and now fairly takes rank as a national institution. One has done this and retained a purely Nova Scotian board of directors. The other has a board made up of four gentlemen of Halifax, four of Montreal, and three of Winnipeg. The majority on both boards consists of men devoting themselves to commercial or industrial business rather than to finance.

Bearing these circumstances in mind one may easily

understand that the point of view and the capacity, both of the executive and of the employees, would broaden as the banks themselves broadened. Every one connected with a bank of this type would be apt to think broadly on financial questions. The executive of such a bank can usually be counted upon to take patriotic action whenever the country is threatened with a crisis. Yet it should not be supposed that these banks, on widening their scope of action, became cold or forgetful in regard to the interests of the particular province in which they originated. The bulk of the stock is still held in the maritime provinces. The extension abroad and into the other parts of Canada has the effect of enabling those Nova Scotia owners to draw a yearly revenue from the commercial and industrial activity prevailing in the other provinces and outside the country.

Wide Scope of the Canadian Banks

These two Nova Scotia banks have been mentioned particularly because their history constitutes a good example of local banks starting in a small province at one end of the Dominion and spreading over the whole land. Most of the important institutions in Ontario and Quebec have spread east and west. Everybody knows how world-wide is the business of the Bank of Montreal, and how the Canadian Bank of Commerce also covers every part of Canada, and how it participates in financing the business of certain parts of the United States as well. Enough details have been given to show how natural it would be for branch banks established in one state of the American Union to spread into other states near by, and into other parts of the country. But they would not thereby lose their particular usefulness for the home state or section. Most of the larger banks, no matter what section of the country they belonged to, would find it necessary or advantageous to have a branch in

New York City similar to the New York City branch of the Bank of Minnesota.

Wall Street's Control Over the National Resources

It is now in order to discuss the probable effect of this movement on the matter of Wall Street domination or control over the banking resources of the nation. There are a great many people in the United States who, whenever branch banks are suggested as a remedy for existing evils, shiver with apprehension over the prospect of the branch system being used as a means of extending or enlarging Wall Street's control over the national resources of cash. They imagine that as soon as the laws permitted the establishment of branches on satisfactory terms the various Wall Street cliques, which now control a number of the large banks in New York City, would immediately proceed to possess themselves of the banking resources of other cities, and of the towns and villages; and that finally they would have an iron grip on the banking business of the country. One need have no hesitation in saying that such ideas are unwarranted. I have already ventured to suggest that the measure of control over the banking resources of the United States enjoyed by those Wall Street capitalists would be lessened, not increased, by the institution of branch banking; and I shall now indicate further reasons why it appears that that will be so.

In the first place let us examine the expansive capacity, in the way of acquiring branches, of the great New York banks which are so much feared and suspected throughout the country districts. In what manner would their branch extension take place? It would be a mistake to suppose that they would have it in their power to acquire all the interior banks which now use them as correspondents or reserve agents. Many country

banks carrying balances in the great metropolitan banks do so solely because of the size and strength of the city institutions. The country bankers wish to have their funds in the safest depository available; therefore, many of them select the largest banks to act as correspondents and reserve agents. But it does not follow that any particular interior bank would be favorable to these same large metropolitan institutions when it came to the point of deciding the question as to what bank was to absorb and operate it as a branch. The interior bankers would be much more likely to give the preference to some bank or banks in their own neighborhood or section.

Chicago's Strength in Commercial Banking

I confess that my own opinion is that on the institution of favorable laws regarding branch banking the Chicago banks would be more active than the New York institutions in extending their branch systems into the country. My chief reason for so thinking is that it will be commercial business that the branches will be obliged to transact, and the great Chicago banks apparently give a large share of their attention to carrying commercial accounts. One hears occasionally of the absorption of some commercial bank in the down-town district of New York by interests devoting themselves particularly to financial banking. And in that sense financial banking appears to be on the increase in New York City, and commercial banking appears to be on the decrease. A bank that preferred to devote itself chiefly to financial banking, if it had liberty to establish branches wherever it pleased, would hardly go outside the great cities. So it is to be expected that each one of the great financial banks of New York would endeavor to acquire a banking institution in each of the principal cities to act as its branch. It is well known that some of the New York institutions already have control, through stock ownership, of local

banks in other cities and in other parts of the country; and doubtless these controlled banks would be operated as branches as soon as it was legal and expedient to do so.

The Branches of Financial Banks

One can scarcely suppose that the leading banks now operating in Chicago, Philadelphia, Boston, St. Louis, San Francisco, Minneapolis, and Kansas City, those at least which are now really independent, would be disposed to listen favorably to proposals of absorption formulated to them by the great financial banks of New York. Those leading local banks would be naturally inclined to develop branch systems of their own rather than to become mere branches of New York institutions. Their directors are men of great prominence in the commercial world, and they are animated by a strong local sentiment. As every one of the cities named is admirably situated for a banking head office, it is extremely probable that every one would become the seat of government for a number of strong and important branch banks.

So the purely financial banks of New York, in securing representation for themselves in the other principal cities, might have to be content with acquiring or absorbing banks with a secondary standing in point of size; and in some cities they might find it necessary or desirable to engage a manager and staff and build up a business from nothing. But it may be assumed that a branch maintained by a New York financial bank in an interior city would be obliged to do considerable commercial discounting whether its executive desired to do so or not. Unless it did so it would find it extremely difficult to get or keep a fair share of the purely financial business. The branches of a financial bank would hardly be found in the smaller cities and towns. If any of them did penetrate that field they would be obliged to do a full business in commercial discounting. For a bank of that kind to go

into a small place and attempt to do nothing but collect deposits would be to make itself ridiculous.

The Great Wall Street Banks

It therefore appears likely that the branches of the so-called Wall Street banks would be found only in the large centres and that they would there do a broader, more catholic business than they now do in New York. Quite probably, with their branches, they would be able to perform their extremely useful functions in a manner even more efficiently than they do to-day. It is also likely that the amount of resources in the possession of the greatest of them would rise to proportions considerably larger than they presently possess; but their strength and importance would not enable them to dominate the important branch banks of the South, the West, and the East, as they now dominate hundreds, yes thousands, of little local banks throughout the country.

A New Balance of Power

One way in which the development of the branch systems in the different parts of the United States might be expected to lessen Wall Street's domination would be through raising in each section a number of important banking powers. Instead of there being a few really great banks in New York, Chicago, and one or two other cities, and no other banks of much importance anywhere else, there would be important banks in every section. At present the heads of the leading banks, from their high position, look out upon a multitude of tiny units. Under the branch system they would look out upon a number of institutions perhaps as large, as powerful, and as well organized as their own banks.

In dealing with the Bank of Minnesota something was said as to how that bank carried its New York cash and

loans in its own possession. If we may imagine, then, that there were in the United States some two hundred branch banks with an average of one hundred and twenty branches to each bank, and each maintaining a branch in New York City, what a change there would be in regard to Wall Street's domination over the cash resources of the country.

Standard Oil and Morgan Banks

It is commonly believed that the so-called Standard Oil and Morgan interests control or influence the operations of two groups of banks comprising the largest and most powerful in New York City. As everybody knows, the banks comprised in these two groups carry the balances of a very large number of interior banks. They have in their hands the greater part of the total balances carried in New York by the interior banks. For these huge sums received from their correspondent banks they merely give credit on their books, and then quite properly regard the funds as their own. Nothing except policy and the exercise of self-restraint on their part need prevent the high officers from lending a large part to themselves or their friends for carrying on stock market campaigns. Or they might, as their enemies have observed, lend the funds to the brokers for carrying a public speculation in stocks, and then call them in again with the object of making stocks fall, so that they themselves could purchase cheaply.

It is not only the balances carried on deposit by the country banks that they have in their control, for, as mentioned before, they also act as agents for interior bankers in placing loans at call and on time. The country banks send them the money; they find the borrowers, and hold the securities. These loans also they might, if they were not restrained by honor or policy, use to a certain extent to enrich or benefit themselves or their

associates. Thus in the aggregate these two groups of banks have a strong grip on an enormous amount of banking resources.

Interior Banks Would Control Their Own New York Business

Now attend to this description of what might happen if the banking business of the country were transferred to a few large branch banks. We have seen that the Bank of Minnesota established its branch in New York and that its New York manager and staff assumed charge of its reserve of specie, legals, and call loans carried in that city. Thus the balances and call loans of one hundred and fifty banking offices mostly situated in the Northwest were taken from the control of large New York banks and handed to the Bank of Minnesota's branch, which, of course, is dominated and regulated from Minneapolis. Similarly, half a dozen or more other large banks owned in the Northwest, each with its quota of one hundred and odd branches, would, through establishing New York offices, take their reserves and their loans into their own possession. The same result might be expected as regards the great branch banks owned in the South, the Southwest, the Middle West, and on the Pacific Coast. Each one of the important institutions would arrange to have a large part of its reserve in its own possession and at the same time have it in New York, where it was most needed. Thus, there is fair reason to suppose that in this way branch banking would materially lessen the extent of Wall Street's control over the banking reserves of the nation, and that they would be carried in a more scientific manner than at present. Also, as pointed out before, each section would have a respectable concentration of banking power to serve as counterpoise to the aggregations of banking capital existing at New York, Chicago, and Boston which now overshadow the whole land.

Conversions of Bank Balances into Cash

Practical men may object that such a large conversion of bank balances into hard cash as is here described could not be carried out. On September 1, 1910, the national banks of New York City held deposits of other banking institutions amounting to $618,056,548, and there were in addition the banking deposits held by the great trust companies and state banks in the metropolis to consider. The answer is that the independent banks could not be converted into branches in masses, as I have here assumed. In actual practice the process of absorption of local banks would probably be slow. In the case of each institution, no matter how small it was, negotiations would be necessary, and in some cases they would be protracted. Then at first there would, doubtless, be quite a number of branch banks electing to do without a branch in New York City. This move they would consider after their branch systems had reached certain proportions. In the mean time they would probably employ the large financial banks of the metropolis as their correspondents and reserve agents. But it may be assumed, if the branch system is made permissible, and if, as Hon. Mr. Vreeland predicts, it crowds out or displaces the local banks by reason of its more economical working, that the huge aggregate of bank balances carried by the New York institutions will dwindle until it reaches much smaller proportions. As these balances now constitute what might be termed a showing of fictitious or false banking power as well as one of the most dangerous features of the present system, there should be general thankfulness at the prospect of their elimination by purely natural means, through the institution of a kind of banking which is acknowledged by its enemies to be economical and efficient.

When the New York State Legislature compelled the trust companies in its jurisdiction to convert a consider-

able part of their bank balances into cash to be carried in their own vaults the change was generally recognized as admirable and salutary. This other change would be of exactly the same nature. Instead of the trust companies it would be the interior banks that converted their balances in banks partly into specie and legals.

How the Reserve Agents Would Fare

One of the interesting problems connected with this supposititious wiping out of the unwieldy total of bank balances is this: How will the great metropolitan banking institutions adjust themselves to the change? It means ultimately the loss of vast sums which they now hold; and a not inconsiderable part of the withdrawals would be in specie. In the chapter on the currency question I shall indicate one source whence the centres might make a large acquisition of cash through the working of the new system. If the branch banks had reasonably liberal note-issuing rights it would come about that a large total of hard cash now carried as till money in the individual banking offices would be released and sent to the centres. This item by itself might furnish enough cash for the branch-bank reserves in New York City; and if that were the case, the liquidation of the bank balances would simply mean the transfer of loans from the presently existing depository banks to the branches of the outside institutions.

Of course it is to be remembered that the financial banks of New York would themselves be acquiring some independent institutions of more or less importance to operate as branches. Immediately a New York bank acquired a bank in the interior that carried a balance with it the balance would be extinguished, since it would be owed by the New York bank to its branch, in other words, to itself. In this way a considerable extinguishing of the balances might be expected. If the banks are given

a reasonable degree of liberty, along with reasonably generous note-issuing rights, and the legislatures refrain from meddling overmuch, there is every likelihood that the problem would solve itself. The movement would take place along the lines of least resistance, and it may be assumed that those great financiers who guide the destinies of the large metropolitan banks, which now hold the enormous deposits belonging to other banks, will devise measures calculated to protect the interests of themselves and of their banks. At any rate, it is certain, if their public utterances are to be believed, that some of the most prominent of them are in favor of branch banking; and it is not to be supposed that, in their consideration of the subject, they have overlooked this feature of the conversion of the balances into cash. Therefore, it may be presumed that they are confident of their ability to liquidate the balances held by them, when the occasion for doing so presents itself, without undue inconvenience and without material loss of earning capacity.

These balances of other banks carried in New York are the source of trouble in other than panicky times. It has been shown that in the panics they are responsible to a large extent for the suspensions of payments. In addition every autumn they are more or less a source of trouble. The withdrawal of balances, in the form of currency, is apt to upset the money market and to send interest rates to high levels. The commercial and industrial interests of the country are the chief sufferers from this circumstance. The skilled financiers at the centres know how to protect themselves; frequently they are able to extract profit from the disturbances.

If Larger Cash Reserves Were Carried

There is one way in which this movement of currency to and from New York might take place, under the system of small local banks, without causing undue dis-

turbance. But there is scarcely any prospect that it will be followed. If the depository banks in New York and other reserve centres ceased altogether to pay interest on these balances, and if, on receiving funds from interior banks in the habit of withdrawing currency in the fall, they held 50 or 60 per cent. of the deposits as cash in vault, instead of putting all but 25 per cent. out at call, they would be able to meet the autumn drain of cash to the interior without disturbing the financial situation. It would, however, involve keeping fifty or sixty millions, and perhaps more than that, idle for several months in every year. One reason the plan is impracticable is that all the different centres could hardly be induced to cease paying interest. If New York allowed no interest and other centres continued to allow it a large part of the funds would be diverted to other cities which do not possess New York's ability to return them.

Cause of the Money-Market Disturbances

I admit that this periodical disturbance of the money market by reason of the currency shipments in the fall is due chiefly to the rigidity of the currency system. And it is contended by the adherents of the local independent banks that if they are given the right to issue notes against their general assets they can provide the currency required for the crop moving without upsetting the money market. I concede that if a satisfactory practical plan of conferring upon the national banks this privilege of note issue can be worked out, it would, perhaps, do away with the customary fall stringency; but there are certain reasons which cause me to think that the exercise of this note-issuing privilege by a vast number of small banks, such as the United States possesses, would be attended by results somewhat different from those which follow the exercise of the same rights by large branch

banks in other countries. And it is quite possible that the plan might not fulfil expectations in regard to relieving the money market in the fall season. However, these considerations will be dealt with more particularly in the chapter on the currency.

Change in New York Banking Conditions

It has been suggested that there might be, ultimately, in the financial part of New York City, some two hundred banking offices, the branches, or principal offices, of the two hundred large banks operating in the United States. On reading this the practical banker will perhaps be disposed to say: "New York is a large and busy city, but I do not see how any profit is to be made in banking if two hundred large banks are huddled together in the financial district competing for all the business that offers." The explanation is that many of the outside banks maintaining branches in New York City would not seek to do a local business. They would confine themselves to acting as correspondents for their own branches and as custodians of their reserve money carried in New York. There would be a respectable number of the whole which would not even perform these functions. They would, perhaps, content themselves with doing much the same kind of business in New York as the agencies of the Canadian banks now carry on there. The Canadian bank agent does not carry specie or legals, nor does he act as correspondent for his own bank. His functions consist in buying and selling foreign exchange, accepting items on Canada for collection or discount, lending the bank's moneys at call and on time against collateral, and buying bonds for investment. The two functions last named are performed strictly under instructions from the head office; and the dealings in foreign exchange are also to a large extent subject to head-office instructions.

How the Money Market Would Be Affected

Each Canadian bank carries funds on deposit with one or more of the large banks in the New York Clearing-House Association, and at all its branches it draws upon these balances. Also the branches send the New York and other United States items which they receive in the course of their business to the correspondent bank in New York and not to the bank's agency. The New York agents have the custody of a large part of the investment bonds, of the collateral security against the call and time loans, and they operate a share of the London account of the bank. If agencies of this description were operated by some of the United States branch banks they would not interfere materially with the local New York banking business.

X

THE CURRENCY QUESTION

Three Remedies

THERE is no need at this late day of assailing the existing bond-secured currency system of the United States. It has few defenders; on all hands its faults are recognized. The national bank note issue is one of the things marked for reform. So, in this chapter it is taken for granted that no intelligent and unbiased American wishes to retain the present system; and that all are willing to see a change as soon as the question as to the best reform to adopt is properly settled.

I have in mind three ways in which the desired quality of elasticity might be imparted to the bank note currency: The national banks as at present constituted might be permitted to issue notes against their general assets, to issue asset currency as it is popularly called; second, a great central bank might be created and to it a monopoly of the privilege of note issue might be given; and, third, the existing banks, national and state, might be permitted and encouraged to develop into branch banks, and the right to issue notes on the security of their general assets might be given to all possessing a certain minimum of paid-up capital not in any case to be less than $3,000,000. It will be profitable to discuss the practical working of these several plans.

The National Banks and Asset Currency

It is very much open to question whether it is possible to solve the currency question satisfactorily through

giving all national banks in the United States, as they at present are, the right to issue notes against their general assets. As soon as that plan is broached there rises up the question as to how the note-holder shall be secured. "By a redemption fund and a mutual guaranty," I hear some one say. "Yes, but what is to be behind the fund and guaranty? Remember, the strong Canadian banks consent to guarantee the notes of all chartered banks in Canada, the weak as well as the strong, because the several note issues are strictly limited as to amount, because the notes are an absolute first lien on the assets of the banks issuing them, and because the Canadian Bankers' Association possesses and exercises the right to examine the circulation records of all the banks. Without the prior lien, and without other special security, it is altogether likely that some of the strongest banks would relinquish the right of issue rather than join in a general guaranty of all notes issued."

How the Bank Notes Should Be Secured

There seems to be a strong feeling in the United States against conferring upon the note issues of the national banks, in the event of asset currency being inaugurated, a priority over the other evidences of debt issued by the banks. It is thought that if it were done the position of the depositors would be weakened. Judging from the tenor of schemes previously proposed it seems likely that the note emissions of national banks would be guaranteed or protected by means of an annual tax laid upon the general issue. Thus each bank would pay to Government an annual tax of a fraction of 1 per cent. upon its circulation, the proceeds of the tax forming the redemption or guaranty fund to care for the issues of insolvent banks. Then the notes would rank equally with the deposits and would share equally with them in dividends paid to creditors.

Of course, in principle, an arrangement of this kind is identical with the vicious schemes of mutual guaranty of deposits which have been so generally and so justly condemned. Honest and able bankers are levied upon to pay the losses incurred through the operations of the dishonest and incapable. But as the payments and liability of each bank would be limited to perhaps ¼ per cent. per year on its outstanding note circulation, many bankers would not object to the scheme.

The Note Issues Must Yield a Profit

If a currency scheme such as this is to be successful it is essential that the bankers find a profit in issuing notes. For if note issue involved a loss they would not create currency, no matter how much the country needed it. We have seen that the hypothetical Bank of Minnesota made a profit of about 2.47 per cent. on its note issues. This can, perhaps, be taken as about the rate of profit made by the Canadian banks on their ordinary note issues. Deduct ¼ per cent. from that and 2.22 per cent. is left.

The Necessity of Redemption Facilities

Though the Canadian banks may count upon a profit of over 2 per cent. on their note issues, and though the hypothetical Bank of Minnesota, after paying the tax of ¼ per cent., could still, perhaps, show a profit of 2.22 per cent., it is altogether likely that note issues by non-branch banks could not show a profit equal to either of these if adequate provision is made for the prompt retirement and redemption of currency not needed by the country's trade and commerce. If the note issues are to do their work properly, and without damaging or endangering the general financial and business situation, adequate provision of this kind must be made. If that

is not done, if any bank may put its entire authorized issue into circulation without having to make daily redemption of such notes as are not needed, grave dangers would threaten the country. Gold might be driven out and the conditions would be favorable to inflation of prices. The object of any change which is made in the currency system would be to introduce elasticity. What is wanted is a system that will automatically create additional currency when the country has special need for it, and then automatically retire the extra portion when the special need for it expires or passes away. Unless the new style of currency possessed this quality of elasticity there would be scarcely any reason for making a change. To get elasticity, facilities for redemption must be provided as well as facilities for issuing. Now let us see what practical arrangements for redemption are possible.

An Exact Measure of the Public Requirements

Before discussing them I shall explain how it is that the Canadian bank note issues possess their quality of flexibility, how the outstanding bank note circulation cannot do other than measure exactly the Dominion's need for circulating medium. It is to be borne in mind, first of all, that the notes of the chartered banks constitute practically the whole currency used by the people in day-to-day transactions—excepting the subsidiary coinage, silver and copper, and the Dominion Government "ones" and "twos" which are used for small change.

Why Redemption Is Thorough in Canada

It is an easy matter to explain why each bank in Canada uses every means in its power to get its own notes into circulation. Each bank is interested in inducing its customers and friends to use its notes in making their

payments. Each one strives to get as much of its authorized issue as possible into circulation. If a customer, in transacting business at his bank, shows a parcel of notes of other banks, of Dominion notes, or of United States currency, he will most likely be asked to exchange them for his own bank's notes. Of course in all its payments the bank pays out its own notes exclusively while it has an unused margin of authorized issue, except for the small change, of denominations less than five dollars. It is eagerly collecting the notes of its competitors and of other obligants, withdrawing them from circulation in the hope that a vacancy will thereby be created into which it may put its own notes. This policy is vigorously pursued all through the year except during the period, if any, in which the bank's own circulation is up to the authorized limits. When that happens the bank has nothing to gain through withdrawing the notes of its competitors from circulation, and it becomes indifferent about the matter. There is considerable expense involved in collecting and forwarding for redemption the notes of other banks.

The Provincial Redemption Agencies

According to the Canadian banking law each chartered bank is required to provide and maintain a redemption agency in every important province. This agency in the case of each province is to be at the recognized financial centre. Take the case of a bank branch operating in a small Manitoba town without opposition. In the towns round about will be branches of competing banks, and their notes, as well as the notes of Winnipeg banks sent out by the large grain firms, will be circulating freely through the whole district. Every day over the counter at the branch in question will come a goodly amount of these notes of other banks, or "sundries," as they are called. The branch ships them all to its Winnipeg branch as they accumulate into $1,000 parcels, which in the busy

season will be nearly every day. They are sent by express or by registered mail insured. Take a different town in the same province where the branch has opposed to it a branch of another bank. Here there will be a daily exchange between the two branch banks of each other's notes along with the daily exchange of checks, etc. So neither has to pay any transportation charges on the notes of its competitor which are received over the counter. But all others must be shipped to the centre. If there are three banks represented there will be an exchange of notes among the three. In the centres no transportation charges are to be paid on the receipts of bank note currency, since every note of the Canadian banks has a branch or redemption agent to redeem it.

When the Note Circulation Is Near the Limit

In connection with the circulation of its notes at all branches other than the centres, each bank is constantly shipping out sundries and shipping in its own notes. The expense thus involved, and the other expenses attendant upon the circulation of the notes, are borne or accepted because the note issues yield a satisfactory profit over and above the expenses. All banking readers will doubtless see from the foregoing that there cannot be in circulation at any time a volume of currency greater than the business of the country calls for. The desire of each bank to push its own circulation causes it to withdraw from circulation as many of its competitors' notes as it can. As soon as it gets possession of other banks' notes it hurries them forward for redemption. This process of redemption goes actively on all through the year except during the two or three months in the height of the grain season, when the issues of most of the banks are close to the ordinary limits. Prior to the going into effect, in 1908, of the amendment to the Bank Act which authorized the banks to issue excess currency between

September 30th and the end of the following January there was a period each year during which most of the banks in Canada paid out over the counter sundries as well as their own notes, in the same manner as is done by the banks in the United States. But as soon as the need for currency in the wheat fields became less urgent each bank would find that its customers and the customers of other banks were depositing and paying in more currency than they were drawing out. As each branch must report regularly to the head office the amount of the bank's own notes on hand, the effect of this movement is quickly seen by the executive. When it becomes clear that the tide has turned, all branches are again instructed to push the circulation vigorously, so as to get all possible profit from the note issue.

The Branches Facilitate Issue and Redemption

Since the 1908 amendment was passed some of the banks have used the right it gives them to issue excess circulation in the grain season. But it is complained that the tax of 5 per cent. levied by the Government creates conditions under which the excess currency can only be issued at a loss by banks which are in strong position. Probably it will be necessary to reduce the tax to induce the bank to have recourse to the right as generally as could be wished.

It will doubtless have occurred to the most thoughtful of my readers, in connection with this matter of the circulation and redemption of the notes, that both are facilitated and made less expensive because of the existence of comprehensive systems of branches. The following is an extreme case illustrating how the existence of the branches conduces to the profit on the note issues. The Bank of Montreal branch in Halifax, Nova Scotia, may pay out $1,000 of its own notes to a customer who sends them or carries them to British Columbia, where

they are put into circulation. Eventually they are redeemed by the Vancouver branch of the bank, which pays cash or gives credit for them and uses them for its counter payments. It may very likely develop that through receiving and redeeming these notes the Vancouver branch is saved the expense of bringing $1,000 of its own notes from Winnipeg or Montreal for counter purposes. It is the same at all branches. Each one applies all of the bank's own notes redeemed by it to use for counter payments, and requires to bring in that much less from the depot branches. A considerable number of branches are not obliged to import any notes, because the circulating medium in their districts is so strongly impregnated with the bank's notes that they get enough of them in their daily receipts to supply their needs.

Note Issues of Isolated Banks

Let us now investigate the practical working of the circulation and redemption of the asset currency which would be emitted by the isolated banks of the United States. I shall presume that the terms and conditions of issue are favorable enough to induce each bank to strive earnestly to keep its own notes in circulation up to the authorized limit. No matter where one of these banks of issue was situated there would be opportunities presenting themselves continually for the circulation of its notes in far-away places. Its customers and payees would be continually drawing cash from it and sending the money by express or through the mails, or carrying it with them on their travels to other parts of the United States. By taking advantage of these opportunities it ought to be comparatively easy for small banks with authorized issues of $50,000 or $100,000 to keep the whole amount outstanding all the time. At each place the body of the circulation would be obtained through the payments over the counter for carrying on the business of the town

or village. A large proportion of the notes so paid out would come back next day, or in two days; more would come in three days or four days. But, as fresh emissions of notes are taking place all the time, a good part of the authorized issue would be in play. The remainder might easily be put out through the payments or shipments to far-away points. And it might develop, when crop-moving came round, that many of the banks had no margin of authorized issue to use. This would be likely, for one reason, because of the expense and trouble involved in redemption.

The Labor of Sorting and Returning

Go back once more to the Canadian practice. In withdrawing the notes of competitor banks from circulation and forwarding them for redemption there is involved the sorting of the notes. At present there are twenty-nine* going banks in Canada. In any district outside the cities there would probably be a dozen or fifteen banks the notes of which would figure largely in the circulating medium. As they come in over the counter the receipts of notes are to be sorted—each bank's issue is to be put together by itself. So there would be, in the sort, a dozen or fifteen piles of some importance, and scattered notes of, perhaps, a dozen other banks which had no circulation of consequence in that particular district. Even in the largest cities the sort calls for only twenty-two or twenty-three piles.

But there would be a vast difference in this respect in the United States. Instead of twenty-nine issuing banks there would be six or seven thousand. A parcel of $1,000 in fives made up from the counter receipts anywhere in the Union would, perhaps, consist of one, or two, or more notes of one hundred and fifty separate banks. In a

* The number has since been reduced to twenty-six.

parcel of $10,000 might be found the issues of eight hundred or nine hundred banks. If redemption is to be prompt and thorough these receipts of notes must be sorted daily at all banking points of any importance. The obligations of each bank must be placed by themselves and returned to the issuers. Consider the enormous trouble and expense connected with this operation. No branches are at hand conveniently located for redeeming the issues of other branches and anxious to use the notes for their own purposes. Each note must go back to the identical office that issued it, even if it is the emission of a Maine bank that turns up in San Francisco. I do not see how this difficulty is to be escaped if redemption is to be effective and prompt. Some persons might argue that arrangements can be made whereby the banks may pay these sundries or other banks' notes in bulk, without sorting them, into a branch of the United States Treasury or to a general redemption agency. But that would be merely shifting the work to other shoulders. The sorting and shipping must be done in any case, and the expense and trouble would still remain.

If Redemption Was Not Thorough

These considerations as to what would arise in actual practice make it appear that there would not be prompt or thorough redemption of asset currency issued by single-office banks, as the individual banks would not take the trouble or do the work necessary to effect it. In those cases where the receiving bank was able easily to keep its own authorized issue outstanding there would be no incentive. Perhaps the country banks would ship their surplus currency to the centres without sorting it and the work would have to be done there by the reserve agents. This practice might lead to a rearrangement of the terms on which the reserve agents received shipments of currency from country correspondents.

So in view of this serious difficulty it might happen that redemption would not be effective, and that the asset notes issued by the thousands of small banks might remain at or near the maximum authorized amount through the year. If this were so when crop moving time arrived there would be no reserve supply of asset currency available, and the old expedient of drawing hard cash from the centres might, perhaps, be necessary. Perhaps, also, there would be less hard cash in the centres to draw upon, for the bank notes would have a tendency to displace other forms of currency and much gold would probably have been driven to Europe.

Note Issues a Possible Source of Danger

Several other objections to the conferring of rights of uncovered note issue upon a system of small isolated banks occur to the mind, but space does not permit of an extended discussion of them. There is a probability that many of the less experienced bankers would find in their issue power a means of making unwise or bad loans. Then the bankers might be led to think, because they were able to keep their outstanding issues up to the authorized limits in ordinary or normal times, that there was no necessity for being always prepared to redeem them; and when a severe crisis appeared, that had the effect of driving the outstanding notes remorselessly home for redemption, the chances are that the note issues would be the cause of numerous bank failures.

These arguments are based on the assumption that the national banks would find it profitable to push their issues to the limits. It is quite possible, if the right of issue against their general assets is conferred on the national banks, that the tax and the peculiar expenses connected with the issue and redemption would deter the better class of banks from using their powers, because there was no profit, or a profit so small as not to be at-

tractive, connected with the business of note issue. In that event the right of issue would be degraded into a means of raising funds by banks in uncomfortable circumstances. And the scheme would hardly be of much value for providing a good currency.

The Central Bank's Monopoly of Issue

It is time, however, to consider the second alternative —that of creating a great central bank and endowing it with a monopoly of the privilege of note issue. Such an institution, if it is to supply notes to replace the national bank note issues, would require to have very large powers of issue; and, to maintain the credit and convertibility of its notes, it would require to carry a very strong reserve. Presumably it would deliver its paper to other banks as proceeds of loans made to them or as payments for deposits withdrawn by them. Thus, when the autumnal currency drain set in there would be seen a process something like the following: The country banks would forward instructions to New York, Chicago, etc., for the return of their balances in the form of currency. Either the country banks themselves or their correspondents at the centres would carry balances with the central institution, and when the balances were withdrawn the central bank would simply expand its issues. By merely paying out its own notes and sending them to the country, the withdrawals of interior balances might be met, through creating an additional supply of currency for the special need of harvest time. If the New York banking institutions which carried heavy balances belonging to the interior bankers, on being called upon to ship those balances in the form of cash, preferred to borrow at the central bank rather than to liquidate loans made by them to their customers or clients, they might do so; and if certain of the interior banks wished to borrow from the central bank, and could

furnish collateral of the required character, they could do so.

Expansion of Issues During the Harvest Season

It would be reasonable enough to expect that the movement of the crops would cause an expansion of the note issues of the central bank to the extent of $100,000,000 or more, thus effecting an economy in the use of actual hard cash. There need not be inflation either, since when the interior banks found that the bank notes which they had circulated in their district were returning in volume they would forward them to New York or another centre to be presented to the central institution for redemption. It would receive them partly as payment for loans granted by it, partly as deposits by other banks; and it would be obliged to redeem a certain proportion in specie. By January probably the whole amount of the extra issues would be cleared away and the first important stage of the crop-moving would have been handled without causing disturbances in the money markets, or depriving the borrowing classes in the great cities of the accommodation they had been enjoying.

Aiding Small Banks and Regulating the Exchanges

In another way the central bank might be expected to prove exceedingly useful. During a panic, while the system of isolated small banks endures, it might prove a strong bulwark. Institutions in distress, that possessed acceptable securities available for use as collateral, might receive assistance from it. If the central bank itself maintained a high credit, as it likely would, its notes would provide the means of making payments to depositors; and a large amount of currency could conveniently be sent to various parts of the United States through an expansion of the bank's note issues. Then,

the central bank would provide a satisfactory medium whereby the Bank of France or the Bank of England might extend assistance to America. It was remarked, during the last panic, that the Bank of France was prevented from coming to the aid of New York by the non-existence of a medium of this kind.

Finally, it is well known that in Europe the great central banks perform a very useful work in regulating the exchanges and in checking excessive outbursts of speculation. And those parties who advocate the formation of a great centralized institution in the United States consider that it might do extremely good work along those lines. It would also, of course, carry the balances of the Government and relieve the United States Treasury of its banking functions.

Some Objections to a Central Bank

These prospective benefits are, in truth, very substantial, and I have no intention of trying to minimize them. Holding them in mind, it is now proper to take account of some of the important objections to the creation of such a bank. In the first place it might be argued that to create a central bank would be to add a fresh complication to a banking system already too much complicated. Nobody quite knows how such an institution would work in America or what effects it would produce. It is certain that it would be an institution of great power, and that there would be much patronage connected with it. Whether it could be kept out of politics is not clear.

If it performed any banking functions of consequence it could hardly avoid encroaching in some way upon the business and profits of the ordinary banks; and it might quite easily become the centre of much unsettling strife. Then, in regard to its notes, it is to be remembered that the ordinary banks would have no object or profit in circulating them. To the other banks these notes would

be much the same as the treasury notes of to-day, and like the Bank of England notes are to the joint-stock banks of England—hard cash, to be obtained only through parting with an equal amount of cash assets or by means of direct borrowing.

Small Places Would Not Obtain Facilities

All these matters occur to the mind when the question of a central bank is under consideration. In my opinion there is another formidable objection. Believing as I do that the United States will find it necessary to discard the present system of local single-office banks, just as France and England found it necessary to discard it, and that, in the next generation or two, in spite of the present hostility of the legislatures and of most of the interior bankers, branch banks will make their way into the monetary system of the country because of their greater usefulness and strength and their more economical operation, I consider in the event of that development that the central bank with its special privileges would then prove to be a great stumbling block in the way of the ordinary banks, just as the Bank of England with its special privileges was a great stumbling block to the ordinary joint-stock banks of that country. To get its note issues into general circulation the central bank would require to have either a monopoly of issue or some other decided advantage over the ordinary banks. If the central institution and the national banks were on an equality as regards privileges of issue the national banks would circulate their own notes in preference to those of the central bank. So without the monopoly of note issue and without special privileges the central bank could not get its notes into circulation and its usefulness as a provider of currency would be practically nil. And a central bank with a monopoly of issue would be an effective bar to the establishment by the other banks of branches in very

small places, and would thus have a tendency to prevent the development of the banking business along lines calculated to benefit the humblest classes and the smallest localities.

Issue Rights Promote Branch Extension

It is well known that in Scotland the privilege of note issue as possessed by the commercial banks enables them to provide excellent banking facilities for the rural districts and the smallest villages. It is the same in Canada. If the chartered banks of the Dominion had not the right to issue notes against their general assets they would not be found in every little hamlet as they are to-day. On the contrary, the branches of the great banks would be found only in the larger villages and in the towns and cities. They would be established only where there was a sufficiency of profitable business to be had. If a law were passed providing that on a certain date the issue rights of the chartered banks were to lapse, the arrival of that date would turn, perhaps, one-fifth or one-quarter of the branches from profitable offices into unprofitable offices, and they would presumably be closed as soon as possible. One may imagine what a wail of distress would go up from the farmers, retailers, and other country people at the withdrawal of these facilities.

How the Note Issue Affects Branch Profits

Let us examine the position of an individual branch and note how it is that the cancellation of the right of issue would turn a small branch that had been profitable into an unprofitable office. Suppose that at the hypothetical branch in question the deposits are $130,000, the loans and discounts $100,000. Of the deposits $40,000 are free, and $90,000 are subject to interest at 3 per cent. The average rate on the discounts is 6 per cent. The in-

come from such a branch might be: Interest on loans, $100,000 at 6 per cent. = $6,000; exchange, commissions, etc., $1,200; gross profits, $7,200. The outgo: Interest on deposits, $90,000 at 3 per cent. = $2,700; salaries, rents, taxes, and other expenses, $5,000; total outgo, $7,700. The net deficit to be charged to head office is $500.

Now the branch must carry an average of $3,000 with the bank's New York correspondent for drawing purposes, $1,000 in silver coins, and $4,000 in small notes of $1 and $2 denominations (I am assuming that the right to issue is confined to notes of $5 denomination and multiples thereof). That makes $8,000 cash funds carried. As the deposits exceed the loans by $30,000 the branch draws that much of a surplus from the locality. And as it is using only $8,000 of this surplus for its own purposes a balance of $22,000 has been put at the disposal of the head office. Finally, owing to the payments of the bank's own notes at this branch, the note circulation of the whole bank is greater by an average of $50,000 through the entire year. Allowing for a cash reserve of $15,000, or 30 per cent., against the branch's circulation, the parent bank gains the use of a further sum of $35,000. Thus the bank obtains the use of $57,000 from this particular branch at a cost of $500 per year, or less than 1 per cent. (.87 per cent. to be exact). Under those circumstances the branch is profitable, since it is usually not very difficult for the head office to invest the funds at a profit over that ratio of cost.

Loss of Issue Rights Strikes Local Borrowers and Depositors

Next examine the position of this branch when the bank has no issue rights. From the $100,000 of discounts it gets $6,000 as before; the same amount, $1,200, is received in exchange, commissions, etc. The total income is unchanged at $7,200. The outgo also is the same—

$2,700 for interest on deposits, and $5000, for expenses, or $7,700 in all. And the net outgo or deficit remains at $500. The change occurs in the capital position of the branch. First, the bank loses the $35,000 net funds of which it had the use through the note circulation of the branch. Next, it has to keep on hand at this point in $5 and $10 Government notes an average of $20,000, where its own unissued notes had sufficed in the other case (this is in addition to the $8,000 of small stuff referred to in the other description). That makes a difference of $55,000.

Now the relation of the branch with head office is as follows: Deposits exceed loans by $30,000, but the branch has to carry $28,000 in cash and balances, leaving a surplus of $2,000 for the use of head offices or other branches. The cost of this $2,000 is $500 per year, or 25 per cent. Under these conditions this branch would be unprofitable, since no bank can take funds costing 25 per cent. per annum and make anything out of them. So, one of two things would happen: Either the branch would be closed and the people of that locality deprived of banking facilities (or thrown into the hands of a private banking note shaver), or the bank would take steps to make the branch profitable through raising the rate of discount and lowering the rate of interest on deposits. With the average rate of discount at 7½ or 8 per cent. and the deposit rate at 2½ the branch might perhaps be profitable, allowing for a moderate shrinkage of its loans and deposits owing to the less satisfactory rates.

Central Bank a Stumbling Block

This serves as another illustration of the benefit derived by the general public from the conferring upon good commercial banks of the privilege of note issue. It also shows clearly enough how the existence of a central bank with a monopoly of note issue would operate to

deprive small places of much-needed banking facilities, which they would certainly get from the branch banks of the future, if the branch banks have reasonably liberal rights of issue. Then, if the banks of the United States are permitted to develop naturally under the branch system, by which each institution would find a profit in catering to the needs of small places, a central bank would become in a large measure superfluous. There is good reason to believe that the large branch banks of the type referred to could and would do all that the central bank could do, and very likely they would perform the several services and duties in a manner more satisfactory to the people, because they would be much more closely in touch with the borrowing and depositing classes. To get the branch banks all that is necessary is to allow the existing banks to develop along natural and rational lines. They will come into being if the laws are made permissive. There is no need to create anything or to introduce new complications. They will supply the currency that will respond automatically to the country's needs, and they will uphold the country's honor in panics. Perhaps, also, they would regulate speculation and the foreign exchanges as satisfactorily as would any central bank that is formed in the United States.

The Bond Security for National Bank Notes

Of course there is implied in these schemes the retirement of the bond secured national bank notes; and whenever that question is debated the matter of the holding of Government bonds by the banks as security for note issues comes up. It is said that if the Government bonds owned by the national banks and pledged with the United States Treasury as security for national bank notes outstanding were rendered useless for note circulation they would drop in price so much as to inflict a loss of quite $60,000,000 upon the banks owning them.

Of course I do not know what arrangement would be considered by Congress to be expedient or practicable as a measure for changing the status of these bonds. But to my mind there is no doubt whatever as to the course which the Government should take. It sold those bonds to the banks and got a price higher than the market value on account of the valuable consideration attached to the bonds. If it is found desirable and in the public interest to destroy the value of this consideration the Government is in honor bound to return to the banks the surplus price it received by reason of the consideration. It seems to me the occasion should be regarded by the Government officials as an operation similar to that which takes place when a worn coinage is replaced on a large scale by sound full-weight pieces.

Displacing the Government Notes

If the currency of the country were provided by strong branch banks, of the type of the Bank of Minnesota and the Bank of Massachusetts, which had the right to issue notes up to the amount of paid-up capital, these bank note issues would easily replace the national bank notes; and they would, naturally and without special legislation, effectually displace the Government notes of $5, $10, $20, and $50 denominations. These Government issues would then possess no avenues by which they could get into or remain in circulation. It is practically certain, if the banking business of the United States were transferred to the hands of branch banks of the kind described, that the gross capital of the banks would be $2,000,000,000 in a reasonably short time. The aggregate capital of the national banks on April 28, 1909, was $933,269,903, and that of the state banks $410,717,857. With the absorption of outside institutions and the extension of the branches into thousands of new places large capital increases would be necessitated. It is very likely that

many of these branch banks would operate with capital largely in excess of the amount of notes they could maintain in circulation; and each one would be very active in withdrawing the notes of its competitors and in paying out its own. Not one of them would think of paying Government "fives," "tens," or "twenties" over their counters. These they would send in for redemption, and the Government notes in circulation would speedily come to consist of large notes—$500, $1,000, $5,000, and $10,000—used almost exclusively for clearing-house and reserve purposes.

Securing the Branch Bank Issues

It would, of course, be possible to make the branch banks' notes safe and as surely convertible into specie on demand as are the existing national bank notes. A first lien on the assets followed by a mutual guaranty and a redemption fund would appear sufficient to secure that end, especially if the associated guarantors were given adequate rights of supervision over the individual issues. The notes might be made a first lien on the assets without imperilling the depositors if the right to issue and the right to extend branches were confined to strong banks with a large paid-up capital—say, $3,000,000 or $5,000,000—(Sir Edmund Walker, president of the Canadian Bank of Commerce, thinks that a branch bank with the privilege of operating everywhere in the United States should have a capital of $10,000,000 at least). And the first lien on assets could be made the basis for a mutual guaranty by the associated banks of each other's notes. Or, if it were preferred, a tax of $\frac{1}{8}$ or $\frac{1}{4}$ per cent. might be levied, and the accumulation set aside to redeem notes of failed banks. I consider that the prior lien arrangement is more just and equitable. The noteholders are secure in either case. When there is a tax levied indiscriminately on all banks for the purpose of securing the notes, it means that the

good banks are levied upon to protect the noteholders of badly managed concerns. Under a prior lien the noteholders of a failed bank would be protected at the expense of the depositors, who might get 5 or 10 per cent. less in dividends because of the preference given the notes.

A Safe and Flexible Currency

In either case the whole branch machinery would be available for the circulation and redemption of notes. The constant efforts of each bank to keep its own circulation at the maximum would ensure prompt and thorough redemption, the carrying on of which would not entail an undue expense in sorting, express charges, etc. Redemption being thorough, the incentive to issue being always present, if the bank notes provided the sole currency of the country, the amount in circulation would at all times be in automatic adjustment with the country's need of circulating medium. Congestion at the centres, with its attendant invitation for rich manipulators to rig the markets for stocks and commodities, would not be so apt to occur except perhaps during the stagnation that followed an important panic. When crop moving came round there would be every probability of the branch banks being in position to easily create the additional currency required for the financing thereof.

I think I have made it clear that branch banks of the right type could supply currency just as well as, if not better than, a central bank could supply it. And if the privilege of issue were given to the ordinary banks many country districts, and city districts as well, would enjoy valuable banking facilities which they have not to-day, and which they have no prospect of getting under the system of single-office banks.

XI

HOW THE CHANGE MIGHT BE EFFECTED

Avoiding Destruction of Property

PERHAPS, at about this stage of the relation, the reader who is a banker, acquainted with the conditions prevailing in the country, will be moved to interrupt. "That is all very fine," he may say; "the picture you draw of the efficient working of such banks as the Bank of Massachusetts and the Bank of Minnesota, and of the benefits they confer on the people, is attractive, but it is high time for you to describe more minutely some of the details as to how the transition from the present style of banks to the branch type can be made. You doubtless are aware that one reason why branch banks have not been more fully considered as a remedy for existing shortcomings is that a practical method of introducing them without destroying the value of the stock of the existing local banks is difficult to find. Have you a method to suggest by which the change from the one system to the other might be made without inflicting great damage upon the owners of the small banks and arousing their bitter hostility?"

In answer to this interpolation I must admit that I have no positive conviction that branch banks can be introduced without damaging the value of the stock of some of the existing banks. The change would be in the nature of a revolution, and revolutions of this kind quite frequently are damaging to the owners of the system or process that is discarded. However, I consider that there

is a possibility of the change being effected without causing undue loss; and in this chapter I shall endeavor to indicate how that might occur. Connected with the sentiment against branch banks, which has its origin in the fears of the country bankers that they will be destroyed, is another fear that it might prove difficult or impossible to regulate and control large branch banks, and to prevent gross abuse of the power possessed by them. This point, too, will be dealt with in due time.

Misconceptions Regarding Branch Banks

It is clear that some people are opposed to branch banking because they have an entirely wrong idea as to the manner in which the banks that are advocated would be organized and constituted. I asked a banker from the State of Delaware what he thought of branch banks. He replied that a branch bank opened in his town in opposition to the local banks, but it could do no business, and it had to close. This experience would, perhaps, be repeated in different localities, and the bankers and other people who witnessed it would not get therefrom a favorable idea as to the usefulness or desirability of branch banks. It is reasonably safe to say, however, that in most of the cases here referred to the branch banks were not of the type advocated in this book. I have no doubt that in many cases these unsuccessful ventures were the offshoots of small or unimportant concerns. In other words, the parent institutions had not the size, strength, or prestige required for successful or useful operation. It may have happened sometimes that the opening of a branch by one of these concerns represented a forlorn hope, or effort to attract a few deposits, in some other than the home locality, to bolster up the parent office or to feed it with additional funds for financing the needs of its own borrowers.

A Fixed Capital for Each Branch

Apparently it was branch banking of this type which the Superintendent of Banking in New York State had in mind when he initiated the recent legislation requiring a parent bank to provide a capital of $100,000 for each branch established. As a matter of fact, the capital of the parent bank should be proportioned to the amount of the gross liabilities rather than to the number of branches. Assuming that its funds are well and profitably invested, a bank is able to make the best earnings when its deposits and liabilities are many times its capital and surplus. Thus a bank with capital and surplus of $2,000,000 and deposits of $30,000,000 would likely earn a much higher ratio on its proprietors' funds than would another with capital and surplus of $15,000,000 and deposits of $17,000,000, although both have the same amount of resources to work with—$32,000,000. But, though not so favorably situated for earning and paying large dividends, the business of the latter bank is on a broader basis of capitalization. Approximately half its resources are its own property, not subject to withdrawal. It should be said that many banks do actually carry deposits ten or fifteen times as large as capital and surplus. The high proportion of liabilities to capital and surplus need not necessarily be dangerous provided the officers are careful to carry at all times a sufficient proportion of assets that are immediately available.

So that if the capital is to be proportionate to anything it should be the liabilities. When applied to great mercantile banks, operated as they should be operated, the requirement of $100,000 capital for each branch would simply have the effect of preventing the establishment of branches in many small places. In a locality where the natural demand for discounts exceeded the deposits by one or two hundred thousand dollars it would not be so great a hardship to be required to provide $100,000, or

any other fixed sum, against the particular branch established there; but if a deposit locality is taken—a place where deposits far exceed the loans—it is a different matter altogether. Since the branch in that locality could not use a dollar of the new capital required to be provided for its use, the requirement cannot but operate to prevent the establishment of branches in such places.

Branch Banks and Chain Banks

It is quite probable that some of the methods practised in New York and other cities prior to the 1907 panic would have an effect in disposing people against branch banks, because of their confusing with the branch banks the so-called chain banks as manipulated by the Heinze-Morse faction and by other factions. I may as well explain that chain banks of this kind have scarcely anything in common with the branch bank idea. One of the worst features of the system of local small banks is that it tends to bring about personal domination, through the exercise of stock control by one man or by a clique or set of men. By the chain system, as practised by Heinze and Morse, this objectionable feature of personal domination was extended over a number of institutions instead of being confined in each case to one bank. The system has no connection or similarity with branch banks as they exist in the great European countries, in Canada, or Australia.

In the United States these chains of banks are found in the country districts as well as in the large cities. A correspondent of the New York *Evening Post* at Omaha, Nebraska, described in the issue of April 25, 1908, how the bank chains were worked in the West. After pointing out how towns and villages sprang up on the Dakota plains with the building of new railway lines he says: "Among the first institutions to be started in every town is a bank. Frequently it is there before the railroad

arrives. The rivalry for the title 'First' (either state or national) bank, is keen, and a half dozen applications are frequently made. Two or three banks in operation before the town is a month old is common. Many of these are practically real estate agencies and loan-broking firms with the word 'bank' as an appendage for good will. They handle farms, make farm loans, and write insurance along with receiving deposits.

"The next step in the development of these banks has been their combination into chains. The farm mortgages given by the farmers who move on the new lands which they wish to improve, and borrow money for the purpose, have to be sold; hence the president goes to a large Western city and starts an investment company which makes a specialty of selling farm loans. He leaves the bank in charge of a cashier, who is usually a young man anxious to make a showing. The president establishes other banks of this sort until he has a string reaching across several counties. A banker who left for Spokane last month was president of twenty banks of this sort and lived in luxury without visiting them oftener than enough to keep in touch with their management."

Strings of Western Banks

Banks of this kind are scarcely calculated to inspire respect for the banking business. As a matter of fact, the mere mention of them is sufficient to bring a smile to the face of a banker accustomed to the strong, well-organized branch banks of other countries. Properly speaking, many of them are not banks at all. The men operating and controlling them may know very little of banking principles. Not long ago the *American Banker* published the following item: "—— of the —— Bank in Oklahoma City is making arrangements to start a string of fifteen banks throughout the state, having placed an order with a prominent safe concern for safes." The item

moved the *Financial Post*, of Toronto, Canada, to remark that it would appear that safes were the most important factor in starting a string of banks in the newer territories of the United States. The editor then mentions the fact of the National City Bank of New York having purchased the controlling interest in the Exchange National Bank of Spokane, and a large block of the stock of the Traders' National Bank of the same city—the movement apparently being part of a preparatory plan of the Standard Oil interests to make large investments on the Pacific Coast. After mentioning also the Witham chain of banks in Georgia, the paper concludes: "In these instances we have quoted the branch bank system in a disguised form, and one which involves most of the drawbacks and few of the merits of the English or Canadian system. The rooted objection to non-branch banks is found in individual control. In Great Britain and in Canada it is not the individual but the institution which is paramount. In the United States, under the legal inhibition of the branch system, the individual promoter must necessarily be the controlling force. His branches are all separate corporations, and any cohesion they possess is centred in the one person. This movement for 'strings' of banks is likely to continue. It suggests that the American bankers may as well face the inevitable; but instead of having branch banking in its most objectionable form, they should advocate a system which long experience in other countries has proved most desirable."

Attempts to Introduce Cohesion

It might be said, in addition, that a number of other banking reforms and changes instituted recently, especially since the 1907 panic, constitute, like the above-mentioned, attempts to engraft some good features of branch banking upon the localized system. As examples,

I might mention the provision for the currency associations passed just before the last Presidential election, and the scheme more recently devised by the Comptroller of the Currency, under the terms of which officers of the clearing-houses are to co-operate with the bank examiners in trying to prevent reckless banking. Though the main design to be accomplished by the currency associations is to provide currency during a panic, it is also hoped that in this plan co-operative action will be achieved, or a measure of cohesion between the disunited offices; and from the second plan it is hoped that a more efficient inspection or supervision will result. But so long as the various banks retain their independence it must be that co-operation among them can never pass a certain point; for each independent unit will run its affairs as it pleases and for its own particular good. There will be few instances of a bank taking a losing position for the benefit of an association or of the country.

Another example of the way in which the branch bank idea is spreading in the United States, in spite of hostile laws, is found in the 1909 report of the Bank Commissioner for the State of Wisconsin. He cites the case of a company with headquarters in Minneapolis, which he said owned a controlling interest in more than fifty banks in Wisconsin, Iowa, Minnesota, and the Dakotas. He also states that two other companies have recently been organized in Minneapolis for the purpose of acquiring control of banks now in existence, and of organizing new banks.

His objections to this method of combining the banks are: The president and cashier of the bank are usually outside men with only a few local directors; the management is directed by the holding company; and loans are, in the majority of cases, made to parties resident outside the state.

A Southern Combination

A news item in the New York *Financier* of April 26, 1909, is full of suggestion as to the line along which the movement for branch banks might with advantage proceed. It is a despatch from Aiken, South Carolina, and runs as follows: "The proposition to combine the Bank of Aiken, the Bank of Graniteville, and the Bank of Barnwell into one institution, to be known as the Bank of Western Carolina, has been favorably acted upon by the stockholders of the Bank of Aiken. The stockholders of the Bank of Barnwell will act on April 26th, and those of the Bank of Graniteville at a later date. The merged institution will have its main office at Aiken, and will give the three towns one of the strongest banking institutions in the South. The three banks at present have total resources of over a million dollars. There is much enthusiasm over the prospect."

The Right Type of Branch Bank

Without regard to the degree of success that may attend this particular combination it can be said that it appears as if combinations of this kind open the way for the acquisition of a type of branch banks that would naturally evolve into a banking system offering a reasonable protection for the mercantile and industrial borrowing interests during a panic or crisis, and providing facilities for carrying on large enterprises without making it necessary for borrowers to appeal to all and sundry for accommodation. The banking system thus evolved might also be expected to care for and encourage foreign trade better than is done by the existing system. Finally, the stockholdings would be scattered widely over the land, ensuring a reasonably certain prospect that due consideration would be given to local or sectional interests. Take the three banks referred to in the preceding paragraph:

If the combination is really effective and the management capable and honorable, the stock of each institution should be more valuable after the consolidation, because the business can be held at the same or a larger volume under lessened executive expense. The Aiken executive would be impelled to give every reasonable encouragement to the industrial and commercial development of the other two places, by the wish to maintain or increase profits, to say nothing of the fact that the local stockholding in the other places would exert its influence upon them.

Carry the idea further and suppose this Bank of Western Carolina eventually forms part of a bank with branches scattered thickly through several Southern states. Honestly and wisely administered, would it not be a much more powerful factor in building up the South and in strengthening the financial fabric of the United States than the aggregation of its several units would be while retaining their independent character? The stockholding of the bank so constituted would be scattered in every district where there was a branch; and the task of the Government's supervising officers would be simplified immensely. Instead of one hundred or one hundred and fifty small institutions to be supervised, there would be only one bank.

Free and Natural Development Desirable

It is not to be desired that this state of affairs should come about as directed by the laws or through compulsion. At the Denver Convention of the American Bankers' Association Sir Edmund Walker suggested that if branch banking were merely made permissive it could hardly make its way unless it proved worthy. If the legal restrictions and prohibitions were removed and there was seen a transformation of independent banks into branch banks, as in the case of the Western Carolina affair, on a

large scale, it would be fairly good proof that the movement was economically sound. It would be a mark or sign that for the first time in recent generations the banking development of the United States was proceeding naturally. If the prohibition against branches were removed, and the privilege of note issue conferred upon banks with a respectably large minimum of paid-up capital, it is practically certain that in all parts of the country the banks would combine so as to be eligible for participating in the benefits of note issue against general assets. Apparently there is a growing disposition on the part of the Federal and state authorities to conclude that in the industry and trade of a great country like the United States it is but natural for the development to be in the direction of large combinations and corporations. They are coming more to the belief that it is better to accept this, to cease trying to prevent or check the tendency, and to bend their energies toward regulating the combinations and preventing them from abusing their power. They may, in time, come to view banking in the same way.

Promoting a Combination

Suppose there began among the country banks a movement to combine. The task of bringing the banks together would call for the services of a number or promoters. It would be an attractive proposition which a promoter could lay before the stockholders of the particular circle of banks he desired to combine. He would first select the section of the state or country which he wished the bank to cover. Then he would choose the several cities, towns, and villages in which it would be advisable to be represented and in each place select a bank to be approached. He would also need to provide a general manager and an executive staff. If it happened that the promoter himself was a skilled banker, he might retain the general management for himself. But,

as the qualities required for bringing a score or two score independent banks into a combination such as this are somewhat different from the qualities required for the general management of a large branch bank, it is likely that in many cases the promoters would receive compensation for their services in cash or in stock which they might easily convert into cash.

An Attractive Proposition

In laying his proposition before the officers and directors of a local bank, the promoter would first explain the method to be followed. The combination would not be a case of one bank swallowing another. Nothing like that at all. It would instead be a confederation of banks for the profit and well-being of each unit as well as for the good of the state and country. The assets of each bank agreeing to join the scheme would be valued by an expert familiar with business conditions in that part of the country. If the promoter has succeeded in enlisting the support of a number of respectable institutions, so as to ensure the respectability of the proposed consolidation, he would be taken seriously enough. There would be several circumstances which would enable him to make an attractive offer for the stock of a bank the adhesion of which he desired. First, there would be the economy of operation possible under the branch system. Next, the extra profit to be gained from the exercise of the right to issue notes. Third, there would be the possibilities in the way of expansion of business through opening in many places not possessing banking facilities. All these would have a tendency to increase the profit-earning capacity of the stock going into the consolidation. Another consideration would be that the stock itself would become more easily marketable. Everybody knows that nowadays, as a rule, there is but a narrow market for the stocks of banks in small places. If a stockholder wishes

to sell his holding the chances are he will have to wait till a buyer appears. To make an immediate sale it might be necessary to concede five or ten points from the price recorded in the last previous sale. But the stock of a large branch bank would have a recognized market value. At the particular financial centre where its head office was located there might be transactions every day, as both buyers and sellers would be in evidence continually. So, providing the valuation of the assets did not reveal rottenness, the promoter could safely offer a higher price for the stock of the local bank (to be paid in stock of the consolidated bank) than it was selling for in the local market, because as a branch it would earn more than as an independent concern.

The Stockholders—A True Democracy

The strong points about this proposition would be apparent to any intelligent body of local stockholders. A bank formed in this manner, through the combination of a number of banks in the several places, would command the respect and confidence of depositors and business men. It would be possible to ensure that there would not be domination of its affairs by any particular institution or clique, for the stockholding would be distributed through a wide territory, and the larger places would hold sufficient stock to count in the election of directors. The board and the principal officers would necessarily be men enjoying the confidence of the general body of stockholders. Nor can it be asserted that a branch bank so constituted would be neglectful of or indifferent to the needs of any of the localities it served, or that it would draw the funds that were needed in the country districts away to the centres. Such banks would constitute an eminently rational solution of the banking problem. An institution of this type would gradually extend its operations over the state or section in which it was located.

It might require also an agency at New York, and perhaps at other centres. At New York it would be necessary to lend at call and to invest in bonds and stocks; but it is easy to see that its operations there would be absolutely free from suspicion of control by the powerful market interests of New York City.

An Absolute Preventive of Clique Control

It will be well at this point to take account of the possibility of prominent financiers of New York or Chicago entering into an aggressive campaign for the purchase of stock control of branch banks in various parts of the country. A development of that kind is not at all to be desired. Recent happenings in New York City in connection with the acquisition of control over several large trust companies by an interest which already possessed the control over a very large aggregation of banking institutions indicate that unless something is done to prevent it this form of activity may be much in evidence. I cannot see any convincing reason why it is necessary for those powerful financiers to have absolute control of the banking institutions that carry through their various transactions. In many respects it would conduce to cleaner and sounder banking if the banks that were to advance the funds for great operations of this kind were known to be free from the domination of their borrowers. At any rate a distinguished Frenchman has indicated how the High Finance of the cities can be effectively prevented from extending its domination over banking institutions in different parts of the country. In the Annual Financial Review number of the New York *Evening Post*, published December 31, 1909, M. Paul Leroy-Beaulieu gives his view of the financial situation in America as it then existed. Commenting on news just received of a sale of American company shares placing corporations with a very large

aggregate capital under one control, M. Leroy-Beaulieu said: "This evil financial custom of the United States does not exist in France. If done away with it might be possible to hold your trusts within bounds. This would certainly be better than your present contradictory policies, now granting them every liberty and now trying to suppress them altogether. This despatch says that Mr. Morgan, having bought the majority of stock of the Equitable, will consequently control the finances of that company with all its ramifications. Now such ownership in France gives no such power or control. The number of votes allowed to a single shareholder of a company is strictly limited. The English forgot this when they bought up the Suez shares held by the old Khedive; they expected it would secure them the majority of the votes since it gave them the majority of shares. There was great disappointment when I pointed to the text of the statutes, which limit to one hundred votes any one shareholder, no matter how many shares he may possess. It is not easy to evade this essential rule by dividing up one's shares among fictitious holders, for this constitutes a penal offence in French law. I am sure that something similar, limiting the voting power of great shareholders, would also limit the too-great power of your trusts and combines."

Limitation of Voting Power

Here is indicated a sure and safe method by which the branch banks might be forever delivered from domination by great metropolitan stockholders. Let it be provided that in the case of all banks which have the privilege of establishing branches and issuing notes to serve as currency the stock shall be strictly limited in voting power. A maximum of one hundred votes for any one shareholding, with a provision that the division of shares among fictitious holders should constitute a penal offence,

would make it entirely useless for restless or ambitious financial schemers to try to obtain control of the branch banks in the manner commonly followed at present. To limit the voting power of the stock need not necessarily impair its investment value. It is often the case, under the present system, that a certain interest which has invested heavily in a railway, an industrial concern, or a financial concern, is obliged to buy the stock control in order to safeguard its investment. If the parties did not take that precaution they might some day discover that outsiders inimical to them had secured a majority of the stock, and that there was a good prospect of their investment being destroyed or seriously damaged. In other words, large investors are sometimes compelled in self defence to acquire the stock control of the properties in which they are interested. Limitation of the voting power of the branch banks' stock would give these large investors the immunity they required, and would deliver them from the necessity of acquiring 51 per cent. of the stock for themselves or their friends.

I think that, in the way I have described, the owners of the sound and prosperous independent banks, on going into a combination, would receive property more valuable than that which they surrendered. Quite probably many of the banks which were in reality not in very good shape would be passed off on the consolidations on terms better than the owners had any right to expect. But there would be, almost surely, a number of institutions which were unable, because of their bad condition, to form themselves into branch banks of the desired respectability. Needless to say, these are the weak spots in the banking situation as it exists to-day. The owners of their stock are fated to lose heavily in any case, and if they were put out of existence through the institution of branch banks it would hardly be fair to lay the blame altogether upon the change of system.

The Directorates

The boards of banks having their head offices outside of New York City would be composed almost altogether of leading merchants, manufacturers, and business men devoting themselves to some calling other than finance (these are the classes of men who would get the votes if the voting power of the stock was limited). And, even in the cases of those banks which had their head offices in New York City, probably many of them would have boards in which commercial interests were in a decided majority.

These directors would be held strictly responsible for the proper use of the banks' funds. Their responsibility would be heavy enough to induce them to take measures calculated to keep them informed as to the real condition of their respective banks. It would be idle to expect business men of this type to undertake to personally follow the management through the details of every transaction, or to personally examine the books and records so as to make sure that the affairs of the bank were as they should be, and as the professional general manager represented them to be. A director of a great institution could not do that unless he gave a large proportion of his time to the study of branch returns, reports, and correspondence, and to trips around the branches, unless, in other words, he neglected his other business in order to attend to the affairs of the bank. It is not desirable that this should happen. This director is not an expert banker; he might not become an expert, even if he had a seat on a bank board for twenty or thirty years. His qualifications fit him rather for the conduct of the mercantile or manufacturing business in which he has been engaged, and in which quite probably he has made his fortune. It is best that he continue to devote himself mainly to that business.

Checks Upon the Management

But a large branch bank receiving deposits throughout a wide territory must have a board of directors composed of men whom the people of the country know to be substantial; it is advisable also that these directors should have a large responsibility. It is they who must hire and supervise the professional manager who has charge of the bank's operations. They must satisfy themselves that this manager is capable and trustworthy, and devise a scheme which will prevent him from committing the bank to important risks or important operations outside of their knowledge. This could be done through appointing a permanent auditor or chief inspector resident in the head office, having access to all books and papers, and endowed with the powers necessary for checking up the general manager. This man is, of course, a servant of the bank, but he derives his power from the directors rather than the general manager. In the head office of a great bank with many branches there would of necessity be several highly paid officers of considerable consequence, who, though subject to the general manager's authority, would be too powerful for him to override in an attempt to misuse the bank's funds, and too well conversant with its affairs to be easily deceived by him.

Publication of the Statements

Thus a substantial board of truly representative directors, with reasonably full civil responsibilities, holding office by virtue of the suffrages of the general body of stockholders rather than through the ownership of a dominating interest in the capital stock, and removable without difficulty for misconduct, would be one of the main safeguards possessed by the scattered owners of the bank. The same board of directors, reinforced by the stockholding body, all subject to a double liability on

their stock, should be of some consequence in giving the bank a high standing and good credit in every part of the country. Also regular statements of position should be required from each bank; and the Government might publish the statements in such manner as to enable the interested depositor and the student to follow the changes of position of the individual bank or banks he desires to watch. A statement only five times a year would be too infrequent. Monthly statements would best cover the requirement, and the statements should be in a form that would enable an intelligent and critical body of observers to subject the affairs of each bank to a searching analysis. It would be impracticable for a bank with branches scattered far and wide to furnish to the Government bureau a composite statement until perhaps two weeks or three weeks after the date set for the statement day. If the statement day fell on the end of the month it might be the 10th or the 15th of the following month before the head office of the bank had the returns from all distant branches in hand. And after that the branch returns would have to be combined into a general return showing the position of the whole bank. In Canada it is usually about the 19th or 20th of the following month that the bank statement for the end of each month appears. And it is expedited through allowing the most distant branches to treat the 23d or an earlier date as the end of the month for statement purposes.

Impracticability of a Weekly Statement

It might be possible to publish a weekly statement which would permit the speculative and business interests to determine the weekly fluctuations in cash and liquid balances; but it would necessarily be incomplete and it might not prove entirely satisfactory. The cash carried at the branches in the several reserve centres by each bank, the total of call loans on bonds and stocks

and of balances in the international banks, might be given along with some other particulars; but without the fluctuations of the liabilities these particulars would not convey very valuable information. It would hardly be practicable for a large branch bank to publish, on the day following the statement date, a weekly statement of its affairs, as the New York banks now do. Before it could be done all the branches would have to telegraph their balances to the head office, and that would make a heavy bill of costs.

It would be a matter of the first importance to have these bank statements true and faithful. To wilfully misrepresent the position of a bank of this kind would be a heinous offence, for which the severest penalties should be provided. If the duty of prosecuting offenders were laid upon some body, such as the American Bankers' Association, and all offenders, without exception, were rigorously prosecuted, there would be a fair prospect of the statements of condition being, in most cases, reasonably correct. It should be a penal offence for the executive of a bank wilfully to make a material false statement to Government, and a penal offence also for a branch officer to make a material false statement to the head office.

Publication of Earnings and Dividends

Finally, it is to be desired that the directors submit to the stockholders, and publish annually, a full statement of the earnings and how they were applied. Publicity of this kind is clearly in the interest of the banks. In Canada the good banks find the publication of the regular monthly statements an excellent advertisement. The Department of Finance at Ottawa publishes the statement of each bank in the supplement to the official *Canada Gazette;* and the leading financial weeklies reprint the whole, showing the gains or losses made in deposits, loans, cash, etc., by each bank. Signs of weakness or of over-expan-

sion are usually apparent to the experts who regularly analyze the statements. And, as regards the application of the profits, the banks pay large sums every year to the newspapers for printing their annual reports, which specify the amount of earnings, dividends, appropriations, etc.

Safeguards for the Public

Thus the responsibility of the officers, directors, and shareholders, the publicity given to the affairs of each bank, restrictions upon the loans and business, and the degree of control or supervision exercised by the Washington Treasury in the way of examination (details of which are supplied in the following chapter) comprise the chief safeguards for the protection of the public. Another safeguard for the small stockholders and the creditors would be found in the skilled professional who directed the bank's daily operations. Necessarily the general manager would be a trained banker, devoting the whole of his time and energies to the conduct of the bank. As he would be the hired servant of the institution he need not own any of its stock at all. His engagement will be a matter for negotiation between him and the board. He will work under a contract which obligates the bank to pay him a certain salary for a fixed number of years; and he thereby enjoys a measure of independence of any dominating clique which may exist in the board. This officer will be a man with a national or world-wide reputation, and he will be exceedingly jealous of his good name. It is but reasonable to expect that he and his subordinates will have the keenest sense of their responsibility to the bank and to the public. Every hour of every day the general manager will remember that if the bank experiences disaster while under his charge he probably will get the principal blame—for dishonesty or recklessness if his own acts or policies produce the disaster, and for criminal weakness if he stands by and allows any director or set of

directors to damage it or place it in jeopardy. Therefore, he should be a strong tower of defence against the machinations of evil-minded directors. The whole conduct of the bank is his; the directors are merely representatives of the body of stockholders. So long as they require him to do what is honest and proper they have the right to command him. When they pass these bounds and ask him or order him to break the laws of the country, to place the bank in danger in order to serve selfish ends of their own, or to despoil others of the shareholders, a good general manager is strong enough usually to defeat them. He has his contract and they cannot throw him out. Usually there will be on the board a strong minority of men anxious to do their duty. With the general manager and the other high-ranked officers on their side, and the right clearly with them, they can withstand the others. Especially if it were impossible for a few directors to buy up stock control, could the general manager be depended upon to check wrongdoing on the part of the directors and to ensure that the funds of the bank were put to proper uses.

XII

INTERNAL AND EXTERNAL EXAMINATION

The Bank's Own Inspectors

IN the first chapter, while dealing with defalcations and frauds, I intimated that if they are to be stopped or checked an efficient system of internal examination must exist. To be really thorough and effective bank examination requires to be carried on from the inside, systematically, ceaselessly, day after day, week after week, by specially trained men. It may be doubted whether any better system of inspection of bank offices could be devised than that practised by the leading Canadian banks. Each bank maintains its corps of skilled men selected for their aptitude and ability. Each branch will be visited once, twice, or three times in a year by a skilled banker who has, prior to each visit, informed himself as to every detail of its business. The loans and discounts, the cash, securities, the records of the deposits, the methods of doing business, are rigorously and painstakingly overhauled by a man who probably stands higher in the bank's service than does the manager of the branch. The manager himself, the other officers and clerks, are passed upon by this competent and critical visitor. He gives the general manager his opinion as to the trustworthiness, the capability and promise of each. To satisfy himself that everything about the branch is right and true, and that the bank's interests are well looked after, is the object of his visit. It can be said, assuredly, that when the inspector of a Canadian bank makes his ap-

pearance at a branch the employees do not tell their friends of the occurrence with a wink or a smile. For, if anything is wrong, there is a good chance that he will discover it. And, even if there is no defalcation or wrongdoing to uncover, it is more or less certain that there will be reprimands for loose practices or breaches of the rules, and that adverse reports regarding certain members of the staff will be forwarded to head office. While they are not on their rounds the inspectors are at head office studying the affairs of the branches. They have access to all correspondence and reports. Also, they confer with the general manager and the superintendents of the various executive departments regarding branch matters.

External Supervision Also Required

By means of this inspection from within the Canadian branches are closely watched. But the system of inspection has a weak point: No external supervision or control is provided. It is quite possible that the branches of a Canadian bank might be sound and clean, while conditions at the head office were decidedly bad. That was the state of affairs revealed when the Ontario Bank failed, and the same thing has been revealed in other failures. It was these happenings which Mr. J. T. P. Knight, the secretary of the Canadian Bankers' Association, had in mind when he said, in an address at New York City in 1910, that the Canadian system operated efficiently to check frauds at the branch offices, but that as at present existing it sometimes left the way open for fraud on a large scale at the head offices. An intermittent demand for Government inspection has existed, but it has not been inaugurated, partly because of the difficulty of arranging a practical plan, and partly because the Finance Department of the Ottawa government is reluctant to undertake the responsibility of bank examination.

Mr. H. C. McLeod's Scheme of External Audit

I have referred to the campaign for external examination of banks instituted by Mr. H. C. McLeod, of the Bank of Nova Scotia. His plan, as submitted to the Canadian Bankers' Association in November, 1909, provided for the appointment by the association of a board of auditors to consist of not less than seven full members and of not less than seven associate members. To be eligible for service on this board a candidate must be a member of "the Canadian Board of Chartered Accountants, or of the Ontario Board of Chartered Accountants, or of the Institute of Chartered Accountants for England and Wales, or the Scottish Chartered Accountants, or of such other body of auditors or accountants as may be approved by the association."

Then for each bank the executive of the association shall appoint, from this board, an auditor or auditors who shall "for that year, audit the accounts of the bank, particularly and carefully with reference to the annual statement issued by the bank to its shareholders. The auditors shall, for that purpose, make an examination of the head office of the bank, and shall examine any of the branches if such examination shall seem to them to be desirable."

In their report to the chairman of the board the auditors shall state

"(*a*) Whether in their judgment the inspection of the branches is regularly and efficiently performed by the bank's regular inspectors.

"(*b*) Whether the general supervision of the loans and investments appears to be thorough.

"(*c*) Whether they have obtained all the information and explanations they have required.

"(*d*) Whether in their opinion the balance-sheet referred to in the report is properly drawn up so as to exhibit a fair and conservative view of the state of the bank's affairs."

These quotations are from the appendix to Mr. McLeod's pamphlet on *Bank Inspection*, published in Toronto, 1909.

As the Bankers' Association failed to act on his suggestion, he instituted a campaign designed to force the Ottawa government, through pressure from public opinion, to inaugurate a system of external examination.

United States Banks Accustomed to External Examination

If branch banks were introduced into the United States it is not to be expected that the banks would be left free from external supervision. The people and the banks are already accustomed to governmental examination. Moreover, it is good and desirable that the banking executives should know that there is a power higher than themselves watching them closely all the time, presumably ready to check and punish abuses. But the machinery required for the inspection and supervision of large branch banking systems is so elaborate and special that it is doubtful if the Government could supply it. Even if the United States Government, upon the introduction of branch banks, decided to continue its present practice of examining all the banking offices within its jurisdiction, it is certain that each one of the great branch banks would be obliged, nevertheless, to maintain its own corps of skilled inspectors. It would be compelled to do so in its own interests. The internal examination would be much more intimate than the external. The bank's own examiners would cover much ground which Government examiners would not touch. They would inquire minutely into the matters of increasing the profits or decreasing the expenses, of extending the facilities and business, and they would devote a more concentrated attention to particular loans and investments about which the executive officers were perhaps a little doubtful. No well-conducted branch bank could do without an in-

spection system of its own. And if the Government continued its system as at present, the same ground would be twice gone over; a needless duplication of work and of expense would take place. The observations and quotations given regarding Mr. H. C. McLeod's proposed reform of the Canadian system indicate one way in which this duplication of work might be avoided. Several other methods of supervising and controlling the bank executives suggest themselves. There are some reasons why it appears likely that the people of the United States would prefer to have the supervisory powers exercised by Government officials. Let us then outline a scheme of internal and external examination that appears as if it would offer reasonable guaranty of efficient internal regulation and of effective supervision from the outside.

A Large Demand for Examiners

We may suppose that there are in existence a number of important branch banks, formed through the combination of a large number of concerns that were formerly independent. These banks would require the services of many expert examiners for conducting their internal inspections. It would seem that the persons best fitted for the task would be the Government examiners who had been operating in the districts covered by the branches. As an inspector in the service of a large branch bank a good examiner would assuredly command a larger salary than he could expect while in the Government service. Furthermore, if he demonstrated that he had executive ability, he would, in all probability, rise to an executive position. Thus the good men belonging to the existing staffs of national and state bank examiners might form the nucleus of the inspection corps of the banks. They would get better positions, and would understand what was required of them. Acting under the orders of the banking executives, and always

informed beforehand of the affairs of the branches visited, these men, when assisted by others employed for the purpose, could conduct a much more efficient and searching examination than they can at present examining from the outside. There would be occasion for the employment of more examiners than now are occupied in the service of the Federal and state governments. That seems clear from the fact that the examination of each banking office would have a wider scope than at present. It may be assumed, reasonably enough, that an inspection force so constituted would watch and supervise the branch offices competently and thoroughly. It may be assumed also that it would do so in such a manner as eventually to check very perceptibly the constant happening of defalcations and frauds by bankers, which now tend so strongly to lower the banking business in the eyes of the people. The next question is, in what manner shall the Government exercise its supervision over the executive offices.

How Should Government Exercise Its Supervision?

I acknowledge that there is room for much diversity of opinion on this matter, and I am not at all sure that what I suggest will commend itself to the bankers as a whole. In the first place, it seems to me that a workable plan might be arranged under which a Government officer possessing a knowledge of the work of bank examination and auditing would be allotted to each great branch bank, or to two or more smaller banks. He should have free access to all books and reports, and I think he should be entitled to admission to board meetings. He should have the right to visit and examine such branches as he considers require investigation. It would be his duty to watch all the bank's operations and to see that it observes the law. Also he might suggest amendments to the law if he discovered abuses which were not covered by statute.

He would be there primarily as representative of the Government for the protection of the depositors, creditors, and customers. Also in a less degree he would be a protector of the general body of stockholders against the managers and directors. I am not sure whether it would too much exalt this last mentioned function if it were arranged that half his salary be paid by the Government and the other half by the bank. If that were done probably the objection would be raised that his dual capacity, as servant of the stockholders and servant of the customers, would place him in a difficult position when action was necessary in a case wherein the interests of the stockholders clashed with those of the customers. Such cases might arise in connection with the fixing of the rate of interest on deposits and on loans. I do not think he should have the right to meddle with the interest rates, unless he saw a great wrong being perpetrated. Competition would regulate the interest rates very satisfactorily in my opinion. I consider that with branch banks of this type the competition for deposits and for discount accounts would be even keener than it is at present. If these resident auditors or supervisors belonged to the right type the system of examination, internal and external, should prove more efficient and thorough than the Canadian system. Backed up with the measure of civil and criminal responsibility at present placed upon the directors and managers, it ought to ensure clean and proper operation.

The Audit Companies and the Banks

I am aware that some banks in the United States now employ firms of accountants or auditors, having an international reputation, to certify to the correctness and truthfulness of their statements. Some critics might suggest that a regular continuing examination by these audit companies would supply as much external super-

vision as is required. In this connection I might observe that two or three of the Canadian branch institutions employ English or Scottish auditors to certify the correctness of the balance sheets published with their annual reports. Also audits of this kind are provided by practically all the great branch banks of the United Kingdom and of Australia. However, it is doubtful if an audit of this kind would cover the situation as it would exist in the United States if branch banks were in vogue. Probably the American public would demand a larger measure of control over the banking institutions than the audit companies could practise. Following are some of the shortcomings of an audit of the accounts of a large branch bank by a company of this description: In the first place, the audit company's men do not conduct an examination of the cash and securities simultaneously at all the branches. They merely examine the holdings of several of the principal branches which in the aggregate hold the bulk of the cash. They examine and certify to the securities (bonds, stocks, etc.), held in the head office, and procure certificates from correspondent and other banks as to the securities and balances held by them for the bank's account. In this way they are able to certify that the bulk of the cash claimed by the bank's statement is actually there, that the securities are practically intact, and that the balances with correspondents are correctly stated. They are obliged to mention, however, that they depended on statements from the branches for the data on which they affirm the correctness of the whole balance sheet.

It is, of course, apparent that the only way in which an outside examining authority can satisfactorily examine the cash and securities of a bank with one hundred branches is to have a man appear without notice at the same hour on the same morning at each one of the one hundred branches and proceed at once to count the cash and securities. There is no other way in which an out-

side examiner can ascertain with exactness that the bank's cash and securities are actually there on a given date. It is easy to see that this would be a costly process, and in all probability it would prove impracticable.

An Expert Valuation of Commercial Loans

Another objection is that the audit companies are called in by the bank, which is presumably prepared for the inspection when it comes. There is no surprise about it. The bank is not taken unawares, as should be the case. Usually they have their windows dressed for the occasion.

Also the executive of the bank selects the audit company and pays the fee. In engaging an audit company it thus appears in the rôle of a dispenser of patronage; and though there are a number of houses of such high standing and reputation that a bill of health from them might be taken as conclusive enough, still the fact remains that there are other houses anxious to be employed and which would, perhaps, be not overanxious to offend the powerful banking parties who employed them and paid them.

It might be objected, further, that an audit company would hardly be qualified to pass on the value of the commercial loans and discounts, at a hundred or more branches, which would comprise probably the largest part of the assets claimed by the bank's balance sheet. To value these loans an intimate knowledge of local conditions at a hundred or more points would be required, and a knowledge of the circumstances and prospects of thousands of borrowing customers, many of whom would not appear at all in the commercial agency reference books. Often enough the general manager himself will not know what value should be placed on a large loan or liability account which has been carried by the bank for years and which he has studied most carefully from the beginning. When this is so it is scarcely to be expected that an out-

sider can come into the bank and say whether or not its loans and discounts are worth the figure at which they are carried on the books. To merely count up the totals of the discounted notes on hand would be utterly valueless. In some cases, to have a correct valuation of the loans and discounts would be more to the point, in judging a bank's solvency, than to know that its cash and securities were intact. Under an efficient system of clearing-house examinations, such as Chicago and other cities recently instituted, the clearing-house examiner can arrive at a fairly satisfactory notion as to the value of the loans and discounts carried by a bank inspected by him; but as observed in an earlier chapter, there are limitations to his power, and, while a system of clearing-house examinations may perform excellent work in the large cities, it is not easy to see how it could be extended to the country districts.

Examination of the Branches

In view of these difficulties it seems clear that the responsibility for inspecting and examining the branches should be placed upon the banks themselves. If the directors and management were made responsible for the truthfulness of the reports issued by the bank they would use their best efforts to inaugurate an efficient system of internal checking and examination, and to ensure that the returns from the branches were reliable and truthful. I have already suggested that governmental supervision of the head offices would have an important effect in keeping the executives in order. It is worth while, also, to discuss the advisability of giving the supervisory power to the American Bankers' Association instead of to the Government. If the number of banks were reduced to two hundred, or thereabout, each bank having a long list of branches, the American Bankers' Association would be a more powerful body than it is to-day. At present it is too large and unwieldy. When important questions come

up affecting the interests of the bankers it is often the case that there is a great division of opinion as to the course the association should take; and whatever course is adopted there may be an influential minority, comprising the representatives of thousands of institutions, which is strongly against it. Thus the influence of the association is lessened; its voice is not always the solid united voice of the banking interests of the country. But reduce the number of units to one-fiftieth or one-sixtieth of the present figure, and a different kind of body will be in evidence. The representatives of two hundred large branch banks, even if they are animated by a strong sectional feeling, will reach agreement quickly and with facility while the representatives of several thousand small banks were, perhaps, arguing interminably.

Supervision by American Bankers' Association

It would be possible for an associated body of this description to devise a very thorough and satisfactory system of supervision of the executives of the various banks. The association would be more likely than the Government to appoint capable men for the work. And there would be another advantage: If the business of supervising and examining the banks devolved upon the American Bankers' Association, there would go with it a measure of responsibility for bank failures. No reasonable person thinks of holding the Comptroller of the Currency, or his examiners, responsible for the failure of a national bank under the present system. But if the banks were branch banks, and the American Bankers' Association had the duty of examining them, the people would expect the association to protect them, and the representative bankers comprising the association would feel a stronger obligation to do so. It is probable that the united banks would care for the depositors and creditors of a crippled institution, in those cases where it could

be done with reasonable safety, in much the same manner as the Bank of England and the other British joint-stock banks cared for the Baring creditors in 1890, and as the associated Canadian banks cared for the Ontario Bank creditors in 1906, and the Sovereign Bank creditors in 1908. It should be mentioned that where the branch system prevails the banks are very apt to take that course for their own protection, even when the associated bankers have no powers of examination. If the associations of bankers were given, and were willing to accept, powers of examination and supervision, it would make them more ready to protect banking creditors. Of course it could not be assumed that they would do so in every case, as it might happen that the crippled bank's affairs were in such bad shape that nothing could be done for the creditors.

However, no matter how efficient and satisfactory such a system of supervision by the association might promise to be, it is possible that public opinion throughout the country would be hostile to the idea of conferring this power upon a centralized association of bankers. It is also possible that the bankers would not be willing to accept the responsibility. And if the majority were willing, some of the individual bankers might be strongly opposed to it for very proper reasons. (They might fear that their strong competitors would learn too much about their business and take deposits or valuable discount accounts from them.) So it is likely that the only way in which all parties could be satisfied would be through continuing the Government in its power of supervision.

Visitation of Banks by the Comptroller

Yet another plan suggests itself. It, however, would not be so thorough as those already outlined. Instead of appointing resident inspectors or examiners for the various banks, the Comptroller of the Currency might be

given the power to visit (by deputy) the head offices and branches. Relying upon the responsibility placed by law upon the bank directors and managements the Government might forego the regular inspection of the banks, and call for frequent regular statements. In this case it would be understood that complaints against the banks might be directed to the Treasury Department at Washington. When it appeared that any of the banks were not properly performing their functions, or that they were outraging decency or the law, the Comptroller might investigate and punish. Under this plan the watch kept by the Government upon the banks would not be as close as if it maintained examiners or auditors at the head offices. However, it should be borne in mind that the other plan—of appointing resident auditors—might prove impracticable, or it might not work satisfactorily. A resident examiner might be corrupted; and if he were his presence at the bank would be worse than useless. He might be too officious, and interfere seriously with the proper working of the bank. He might learn all about the business of one bank and then betray it to a competitor. Other contingencies suggest themselves. In connection with any and all of these schemes it is to be remembered that no system of examination should be taken as positively insuring banks against insolvency or bank creditors against loss. Mr. J. B. Forgan expressed this very forcibly in his address at Chicago, from which I have already quoted: "The public must not be deluded into the belief that official examinations will relieve them of the fundamental duty of exercising their own discrimination in the selection of a bank. The entire credit system on which the business of the country is built up having its very basis in the exercise of such discrimination, any delusion which proposes to relieve the public of it would, morally and economically, be most injurious, tending to carelessness and general demoralization in business affairs as well as to a lowering

of the standard of business sagacity and social efficiency."

Uniformity of Banking Laws

Needless to say, it is advisable that the laws relating to bank examination and governmental supervision should be of uniform character. The institution of branch banking of the type referred to in this book would be apt to bring about a transfer of the control over banking from the states to the Federal authorities. One of the main factors operating to induce the small independent banks to change themselves into branches would be the desire to acquire privileges of note issue. The Federal government is the only power authorized to confer that privilege. So the note-issuing branch banks would require Federal charters. If it be assumed that in the course of time most of the banks in the country were converted into branch banks, it would follow that the state governments would eventually find themselves with scarcely any banks of their own creation to control. In each state the bulk of the business would be in the hands of banks possessing Federal charters. Thus it would be possible, in that way, to bring the laws governing banking into uniformity. Congress could then enact a general bank act which would apply to practically all the banks in the country; and the state governments would have no more control over the branch banks than they now have over the national banks. For a considerable time after the change went into effect each state might have a number of small banks of the single-office type, created by and subject to the jurisdiction of the state government. Besides controlling these the different state governments would, perhaps, have power to tax the branch banks for the offices maintained in their respective territories. As they now have no power to examine the national banks, it is not to be supposed that they would have power to examine branch banks having Federal charters.

A Large Measure of Freedom

At the outset, when the branch banks were to be inaugurated, there would infallibly be conferences between the bankers who intended to convert their businesses into branch banks and the Government officials regarding the extent and nature of the supervisory powers to be exercised by Government. Naturally the bankers would wish to have the governmental interference reduced to a minimum. And it would be wise policy on the part of the Government to endeavor to devise a plan that would ensure a reasonable degree of safety for bank creditors, while leaving the banks reasonably free from official interference. It is one of the weighty arguments against the present banking system that it is necessary to surround all banks with vexatious and sometimes unreasonable restrictions because some of the badly managed institutions abuse their privileges. When there are too many legal restrictions of this kind the effect is to diminish materially the usefulness of the banks; and the restrictions do not, in all cases, prevent the abuses.

The happiest state of affairs imaginable would be that in which the banks, without being supervised or controlled, administered their affairs wisely and beneficently, extending a judicious support to all worthy forms of industry, and maintaining undisputed strength and solvency. If a large measure of responsibility were thrown upon the parties administering the several banks, if they were given to understand that as a trial the Government would leave them with a considerable measure of freedom, and that restrictions and provisions for closer examination would be introduced only on proof being supplied that the banks, or some of them, were abusing their privileges and their freedom, the chances are that the best banks would do all in their power to ensure good and clean practice.

If the banks had to appear before Congress in a body,

every ten or twelve years, for a renewal of their charters, as is the case in Canada, the fact would operate as a wholesome restraint upon them in the betweenwhiles.

A Definition of a Bad Debt

Before closing this chapter I wish to refer to certain rules which govern the work of examination of national banks as presently conducted. I have already drawn freely upon the published utterances of Mr. J. B. Forgan, the eminent Chicago banker, in order to illumine certain of the points discussed in this book. I now have occasion to draw again upon the same excellent authority. In his Chicago address (American Bankers' Association, 1909) Mr. Forgan mentions that the clause in the National Bank Act which stipulates that no obligation due a bank can be considered bad until interest is past due six months, and not then if it is secured or in process of collection, operates to keep insolvent banks afloat—through enabling them to preserve the appearance of solvency. Also he points out that the Comptroller i hampered by the Federal courts' definition of insolvency, which is "inability to pay current debts as they mature," and he could be enjoined in the District Court for any abusive exercise of his discretion. Owing to the effects of these laws it is to be supposed that there are now, and always, a considerable number of really insolvent banks masquerading as good institutions and inviting the people to entrust them with deposits. Mr. Forgan says that even the Chicago Clearing-House Association has a natural hesitancy to take action that will result in closing a weak bank. "Conditions must become very bad and expostulation be exhausted before any supervisory authority, however constituted, will assume the responsibility of action that will lead to the closing of a bank's doors. If it were otherwise, and such action were taken simply because something in the bank was unsatisfactory, such

authority would be accused of shutting up a solvent institution, not merely by its stockholders, but by its depositors themselves, in whose behalf the action would be taken."

Weak Banks

Thus it can be seen that there is every probability that under the existing system there will be all the time in business, parading with the good banks and not to be distinguished from them, many weak and struggling concerns practically insolvent, and nobody or no authority willing to take the responsibility of closing them.

And, with regard to weak banks, I admit that in one sense it is laudable to nurse them along slowly and painfully toward solvency or strength. But I think most of my readers who have a knowledge of banking will agree with the *Wall Street Journal* in its editorial remarks on that subject, in the issue of July 20, 1909: "A weak bank in the financial system of any state has no more right to continue in business than has a weak bridge in a public highway. The duty of the public authorities and of public opinion in the one case is the same as in the other. Once an element of weakness has developed, the defect in the structure is to be remedied without delay, so as to make it capable of bearing the full weight of its proper burden, or the thing should be closed up. The weak bank takes away legitimate business from the bank that is safe, and does injury to the business as a whole by spreading general distrust. It should, therefore, be put out of existence with no less expedition than we put out a fire or block up a highway or suspend traffic on a tumbled-down bridge.

"This is not a case in which sentiment, social standing of officials, or hesitation to sacrifice an old institution that has outlived its usefulness can be considered. If a bank is weak it has either got to strengthen itself or go. The machinery of the law cannot be invoked too speedily."

A Scientific Classification of Assets

One of the principal objects to be achieved by the supervisory authorities would be the institution of proper methods of bookkeeping, of internal inspection and regulation, and of handling the loans and discounts. It is a matter of grave importance that the administration of the loans and discounts be of an intelligent and scientific character. I have to thank Mr. Forgan once more for a description of the manner in which the best banks in Chicago classify their loans. At Chicago, in advising bank directors to have a periodical classification, by others than the executive officers, of their banks' loans, he explains: "It may be done by a committee of directors or by a competent auditor, at whose disposal must be placed the statements of customers and all the information available in the credit department. The assets can be divided into five classes, and the result will, I think, disclose to the directors the necessity for a contingent fund such as I have advocated. The percentage of each class to the aggregate total should be shown and the periodical classifications compared with each other. This will disclose the progressive condition of the assets, whether they are growing better or worse, and from the result the management may be judged. I suggest the following classification:

"1. Good, desirable business.

"2. Fair business risks.

"3. Business not desirable as a new proposition, but which policy makes it necessary to carry along for the purpose of gradual liquidation.

"4. Loans which should be liquidated, and on which more or less loss is probable.

"5. Loans so bad that they should be charged off now.

"The respective percentage of these five categories forms a very good criterion of the character of a bank's management. It must be the constant and unremitting

aim of its officers to reduce class 3 to its smallest possible proportion and to eliminate entirely the 4th and 5th classes."

Now, what a remarkable uplifting of the standard of banking there would be in the United States if those highly trained and experienced gentlemen, in Chicago and other cities, who practise such excellent methods in their own institutions, might have the authority to impose those methods upon the thousands of banking offices throughout the country! They might do so under the branch system. It is hopeless to expect material progress in that direction under the system now existing.

XIII

A FIXED LEGAL RESERVE

How the Reserve Law Works

I HAVE remarked, in foregoing chapters, that the introduction of branch banks would simplify the currency question through making note issues based on general banking assets more practicable. Also it has been explained that the branch banks would abolish certain serious troubles connected with the cash reserves. It can be said that the change would have an important bearing upon the matter of the fixed legal reserve. That question, too, would be simplified. At present the national banks in the first-class reserve centres are required by law to maintain a 25 per cent. reserve of specie and legal tenders, while the reserve requirement for country banks, comprised of specie, legals, and balances with approved reserve agents, is fixed at 15 per cent. Another Chicago banker, Mr. David R. Forgan, president of the National City Bank, gave to the New York State Bankers' Association (January, 1908) a lucid explanation as to the manner in which the present reserve law works. He said: "The way the law regarding reserves works is best understood by an illustration. The law requires a national bank in Troy, New York, to carry 15 per cent. reserve. Only 6 per cent., however, need be in its own vault. The other 9 per cent. may be with its reserve agent in New York City. If the deposits of the Troy bank are $1,000,000 it keeps $60,000 at home and $90,000 in New York. The $90,000 in New York, however, is not money. It is

merely a credit on the books of the New York bank against which a reserve (allowing for legal deductions) of not more than $20,000 is kept by the New York bank. When the Troy bank, becoming alarmed, deems it prudent to have a larger proportion of its reserve at home, it telegraphs the New York correspondent to send it, say, $20,000. That does not seem like an unreasonable request to the Troy banker—only $20,000 out of $90,000.

"But when the Troy bank withdraws $20,000 it withdraws all the reserve there is in the world against its deposits, except what is in its own safe, and the New York bank is left with a credit on its books of $70,000, against which no reserve now exists. When the transaction is multiplied by thousands and becomes general, it is simply an impossibility for the New York banks to stand it."

Differences in Reserve Requirements

Though it is recognized everywhere that a bank transacting business on moneys derived from depositors, repayable on demand or at short notice, should always have a reserve fund of cash and surely available assets, it is a most difficult, if not an impossible, task to prescribe the percentage of reserve that should be held by the individual institutions in any country or state. No greater mistake can be made than to assume that some figure arbitrarily chosen will fit the circumstances of all the banks. Every banker of experience knows that the minimum reserve necessary for different banks will vary greatly. A 25 per cent. reserve might be ample or too large for one institution, while 50 per cent. would not be a whit too much for another differently circumstanced. Practical bankers are aware, also, that the percentage of reserve that should be carried by any particular bank will vary with the different seasons of the same year. In one season a small reserve will be quite safe and proper, while in another it may be that double the proportion will be necessary.

At the Denver Convention of the American Bankers' Association in 1908 Mr. Byron E. Walker, the president of the Canadian Bank of Commerce (now Sir Edmund Walker), remarked as follows about this matter of reserves: "The real reserve requirements of any particular bankdiffer from those of other banks in accordance with the nature of its obligations as compared with theirs. It is conceivable that the ideal point at which cash reserves should be kept would be different in the case of any ten or twenty banks which you might select for comparison, even in the same city or community. The bank which acts as banker for other banks needs very large reserves indeed. A bank in the same city doing mainly the business of manufacturers, merchants, exporters, ètc., will need altogether smaller reserves, and a bank gathering the savings of a quiet country community needs much less again."

When the Law Fixes No Minimum

In order to make it clear how the trained banker handles his reserves when left free to use his own judgment, I shall in this chapter resort again to the Canadian practice for illustration. The law of Canada does not prescribe a percentage below which the cash reserves of the bank shall not fall. This is not the result of accident or careless omission, but is the outcome of much discussion and much deliberation on the part of the cabinet ministers and the leading bankers. There has always been a small body of opinion holding that a legal minimum of cash reserve should be fixed for the banks in Canada, as it is for the banks in the United States. But the Government has hitherto agreed with the banking theory, that while the existence of so many small institutions in the United States necessitated a certain measure of governmental regulation of cash reserves, the conditions in Canada are not such as to call for legislation on the point.

The great joint-stock banks in England are not sub-

jected to a minimum reserve law. And if the United States had branch banks it is altogether likely that Congress would endeavor in another way to ensure sound and safe banking practice. When the policy is followed of naming some percentage or proportion of the liabilities as the legal minimum of reserve—to be maintained at all times—the effect is to lock up or render unavailable just that much of the banking resources of the country. If the minimum requirement is fixed low enough so as to do no damage through lock-up, it will be useless as a device for ensuring that the banks lend but a safe proportion of their funds. And if it is fixed high enough to ensure that no banks shall carry too much sail, it must perforce result in a woeful and wholly unnecessary curtailment of the power of the banks to aid industry, commerce, and agriculture.

The Legal Reserve and the Real Reserve

As an example take the case of the New York City banks, which are compelled by statute to maintain a minimum reserve of 25 per cent. in specie and legals. The effect of that stipulation is to make it necessary for those banks to carry in practice a potential reserve ranging all the way from 25 per cent. to perhaps 60 per cent. or more. The 25 per cent. of cash is what they may not use or touch; it must be kept there for show purposes, supposedly as an advertisement or indication of solidity. As a matter of fact, every one of those banks is obliged to maintain a reserve entirely independent of the legal reserve; every one must at times prepare special funds which shall be available for meeting some anticipated withdrawals of deposits, or a series of loans which the bank is under obligation to make to its customers. A real reserve must be more than a mere show thing; it must receive surplus funds and yield them up again. The real reserve of the New York banks consists of specie and

legals only in part. That reported as reserve in the weekly statement is only a part of the real reserve. The rest of it consists of balances in the international banks, bills of exchange, call loans to stock-brokers, and some high-class securities. These items are not disclosed, but they nevertheless comprise a very important part of the real reserve. The amount so kept will run up and down according to the varying circumstances of the banks. Any one who attempts to judge the strength of the banks solely by their holding of specie and legals will make a capital mistake.

The Bank of Montreal's Secondary Reserve

In speaking of the reserve of the Bank of Montreal, Dr. Joseph French Johnson, whom I have already quoted, told the Missouri Bankers' Convention (1909) that in specie and legals the bank carried only about 12½ per cent. of its liabilities. But any one who supposed, from that circumstance, that the Bank of Montreal was not strong would be entirely wrong. The specie and legals usually comprise less than one-third of its real reserve. Call the specie and legals the primary reserve if you like, but the secondary reserve is the account which is really depended upon for emergencies. It is composed of balances in the international banks, call loans in New York and London, and first-class securities available for marketing or as a basis for advances in the world centres. There are one or two features about the call loans of the Canadian banks in New York which make them more available and better reserves than the call loans of the New York banks made in New York. In the address just referred to Doctor Johnson is said to have remarked about the secondary reserve of the Bank of Montreal, which consists chiefly of call loans in New York and London: "Now, the time will come when they will find that secondary reserve a disappointment in my opinion. But at the present time

call loans are a source of more strength to the Canadian banks than they are to our New York banks. Our New York banks rely upon them, as you gentlemen know, unduly, and when the pinch comes they cannot get the money New York owes them."

The New York Call Loans

One reason the call loans are a source of more strength to the Canadian banks is that only one object is kept in view when the funds are put out: It is to have the money immediately available under practically all circumstances. The agents and managers, in New York, of the Canadian banks are not connected, directly or indirectly, with any of the stock market cliques or parties; they are merely the hired professional servants of institutions which have a proud record of fifty years and more of uninterruptedly meeting in cash all lawful demands, and both they themselves and their superiors in the executive offices in Canada are governed in making the loans by the determination to have them unfailingly available at call. Thus they do not let their funds go freely for the purpose of making a better market for stocks in which they are interested; nor do they, in any other manner, subordinate the interests of the bank to those of parties or individuals. The consequence is that the loans are made only to parties who they know will respond at once to calls, and strictly on securities which can be sold in almost any kind of a market, a full 20 per cent. margin being required in every case. The rates of interest they get are a secondary consideration; the first is immediate convertibility. It therefore develops in practice that lists of their borrowers are composed of names of the foremost financial houses in America, of firms and corporations which would make it a point of honor to respond on the instant to demands made upon them; and the securities offer a certain means of repay-

ment even if the borrowers failed to respond, as they are selected for their marketability.

Perhaps it will be observed that these are merely good, old-fashioned banking principles, and that plenty of United States bankers are governed by them. But it is well known that some of the important banks in New York are closely connected with market interests and transactions. Quite probably in that fact is to be found the reason why the call loans are a source of more strength to the Canadian banks in Wall Street than to this section or party of the native institutions.

Native Banks and the Money Market

If there were in operation a number of large branch banks, representative of the different parts of the country, with head offices and stockholding in the various sections, and New York agencies or branches in charge of officers similar to the Canadian agents, then the call loans made by them in New York would most probably be on the same basis as the Canadian loans, and they would be nearly as available in case of a crisis. The word "nearly" I use designedly, for there is another circumstance which operates to make call loans in New York owned by foreign bankers more surely available than call loans owned by the home bankers. The home bankers are under a stronger obligation to maintain financial stability or equilibrium. Thus a large United States bank might desire to call in some of its loans in order to strengthen its store of cash; and it might find on proceeding to do so in a time of crisis that the process caused great disturbance to the markets and threatened to upset values. From motives of public policy, because of the obligation to support or uphold the good name of the city and the nation, under which it feels itself, it may desist from calling, probably acting with other banks. The Canadian and other foreign bankers are not under the same obligation to main-

tain the financial equilibrium in that city. They are, of course, concerned in the maintenance of stable conditions, but not to the same extent as the New York bankers are concerned. If there were a serious crisis in Montreal, and the situation there demanded the shipment of much gold to the Dominion, the Canadian banks would liquidate their loans and balances in New York as expeditiously as possible, and they would not be deterred therefrom by the fact that their action threatened to upset New York quite seriously. It would be the same if the New York banks carried a large line of call loans and balances in London as an integral part of their real reserve against liabilities. If that were the case, and a crisis developed in the American metropolis, the New York bankers would not hesitate to call home their funds as quickly as possible, and they would continue the process even if it upset London very considerably. In both these cases the responsibility for maintaining financial equilibrium would not lie with the foreign lenders, and for that reason the call loans made by them are better reserves than are the call loans made by the home or native banks.

Controlling the Branch Bank's Reserve

In the head office of each one of the large Canadian banks the chief executive officer, always the general manager, will have a daily statement of the reserves laid before him. This statement will comprise the cash held by the branches in the different financial centres, the call loans in New York, London, Montreal, and Toronto, and the balances carried in other banks home and foreign. A number of the smaller banking institutions rely to a considerable extent upon their Canadian call loans as reserves. The larger institutions do not. For it is well known that the Canadian stock markets are not broad enough or strong enough to stand heavy realization of call loans by banking lenders.

Now, the general manager knows in a broad way to what the bank stands committed in regard to new loans for its regular customers. He knows in what season the advances to the cotton mill customers will be at the maximum, when the grain buyers will need their heaviest accommodation, when the lumber manufacturing concerns will lean the heaviest; and with regard to the shoe manufacturers, the farm implement manufacturers, the iron and steel industries, the jobbers and wholesalers in various lines of merchandise, railway contractors, retail merchants, farmers, and all the other classes of borrowers, he knows when their demands upon the credit facilities supplied by the bank will affect its resources the most. He regards the bank's obligation to support its mercantile borrowers as a liability, as well as its obligation to pay its deposits when demanded. So far as the deposits are concerned he cannot tell what their course will be. As long as the bank's credit stands high, and as long as conditions are prosperous, he can count with more or less confidence upon a steady acquisition of new funds from the depositors. He aims to make these gains in deposits provide the wherewithal for taking up a number of new discount accounts, for increasing the accommodation given to certain of the bank's old customers, and for adding something to the cash reserves.

Critical Observation of Competing Bankers

All branches have instructions to advise head office at once of important transactions put through by them. In the case of large loans the authorization of the executive must be obtained in advance; but after the authorization has been given, the general manager expects to be informed of the details of the actual carrying out of the transaction. Thus the manager at head office has before him each morning the record of cash, call loans, and balances as at the close of the preceding day. There will also be ad-

vices from certain of the branches as to new deposits gained or old deposits withdrawn, new loans made or old loans paid off. From the tenor of these advices he can tell, in a general way, whether the cash is likely to be augmented or subject to drain in the next few days. Now, this general manager is operating the bank with the object, primarily, of earning profits for the stockholders. In carrying out this design one of the essentials is to maintain a showing of reasonable strength in cash assets at all times, and of great strength in cash assets on some special occasions. The law does not prescribe a hard-and-fast line below which his reserves must not fall; but the general manager is acutely conscious of the fact that the skilled professionals at the head of the various competing banks are accustomed to sit in critical judgment upon his monthly statements of position, and he knows what kind of remarks they will make if he allows his available reserves to fall persistently below the standard regularly maintained by the first-class banks of the country. If he does that there is danger, too, that outside financial and commercial circles will quickly note the fact, and the bank may lose deposits or other good business in consequence. To offend grievously in this respect for any length of time would probably bring a rap from the Finance Department of the Ottawa government; and the offending banker would, perhaps, be requested to curtail his loans. His mortification would not be lessened by knowledge that his brother bankers in other institutions were aware of what had happened to him. He knows very well, also, that if his bank should get into difficulties it might be necessary for him to apply to these brother bankers for aid.

Forty Per Cent. of Available Assets

These are some of the considerations impelling him to keep his reserves strong. On the other hand, he has no wish to carry a great deal more than is necessary in the

form of non-revenue-bearing cash. A certain degree of strength attracts depositors and other customers; but a too-great strength in cash reduces the bank's profits and diminishes its usefulness. He will, therefore, carry so much specie and legals, so much of balances in banks regarded as well able to continue paying through a crisis, so much in foreign bills of exchange, so much in foreign call loans. All these items taken together comprise his reserve. They will probably amount to 40 per cent. of his liabilities. Behind them will lie the call loans in Canada, which, though not so much depended upon, would yield a certain amount of cash in a crisis; and among the current loans and discounts would be a number of items approaching maturity which could be turned into cash as they came due without throwing the commercial business of the country into disorder.

The point is that all these different forms of reserve money are available for use; they are not held merely in fulfilment of the laws, or for display or statement purposes.

Canadian Cash Reserves More Effective

There are two circumstances which make a given amount of cash reserve carried by the Canadian banks more effective than the same amount carried by the United States banks. One is the absence of laws requiring the maintenance of a fixed reserve; the other is the existence of the privilege of note issue.

Because of the absence of legal compulsion regarding the amount of reserve that must always be on hand, the Canadian bank may treat the greater part of its cash as something which may be used or paid out if the necessity for doing so arises. Take a national bank in the United States during a crisis or emergency. In its case there is no right of issue—at least none worth anything—and there is a provision for a legal minimum of reserve. Therefore in paying out the banker keeps in mind that

he must preserve that legal minimum inviolate, and that he must have on hand something for use as counter or till money which will meet the demands of his depositors and other customers for a short while. In other words, a sum of his resources equal to the legal minimum plus a certain amount of necessary till money is theoretically tied up and remains unavailable.

The Canadian banker, on the other hand, may use all his cash without fear of breaking the law, and the bank's own unissued notes provide the bulk of the till money he needs.

Watched by the Bankers' Association

The only clause in the Canadian Bank Act which deals with the matter of the cash reserves is that directing that the banks shall have 40 per cent. of such cash as they do hold, in the form of Dominion notes. This clause was introduced many years ago, when the financial position of the Dominion Government was not as strong as it is to-day, and was obviously designed to stimulate the circulation of Dominion notes. Though not now needed, it has been retained at each renewal of the bank charters.

Though the laws say nothing about the per cent. of reserves that shall be carried, I have referred to some circumstances which operate to induce the banks in the Dominion to carry reserves of proper strength. All the banks in Canada belong to the Canadian Banking Association. Every month, as the bank return appears, the officers of the association compile a carefully calculated statement of the reserves of each bank. The men who construct this statement and study it are skilled bankers. They know what are the circumstances of the individual banks, and what is a reasonable and proper reserve for each one to carry. They take into account the changes of condition due to rotation of the seasons, the expansion of note issues and of current account balances; they make

due allowances for peculiarities of liabilities; and they count the secondary reserve as well as the cash. If it happen that a particular bank is, in their opinion, spreading so much sail as to endanger itself and the banks in general, the Minister of Finance will be officially notified, and a representation from him will probably result in a rectification of the position complained about. If it does not, there remains the extreme disciplinary measure of expulsion from the clearing-houses. Thus there is available coercive machinery of the most drastic kind.

Supervision by Clearing-House Committees

With regard to the conditions in the United States, I have already referred to the increasing disposition shown by the clearing-house committees in the various parts of the country to exercise supervision over the practices of the individual member banks. In their respective spheres of jurisdiction these committees now take an active part in putting pressure upon banks that offend against good banking principles. The present Comptroller of the Currency, Hon. Lawrence O. Murray, has worked effectively to bring about co-operative action between the governmental bank examiners and the clearing-house officials. And, as a result of such co-operation, each of the various clearing-houses may become informed of objectionable or dangerous practices of banks in its constituency. An intimation that unless these practices are amended the offender will be expelled from the clearing-house would almost certainly have beneficial effects. Possibilities of improvement to the banking practice through the gradual extension of this policy are large. It promises most, however, for the cities where clearing-houses exist. It can hardly be expected to exert so great an influence upon the actions and practices of banks situated in the smaller towns and in the country districts where no clearing-houses are found.

Abolishing the Legal Minimum

In the foregoing paragraphs I have indicated how the stipulation as to a fixed minimum reserve might, with safety and advantage, be removed from the statute book if the banking business were in the hands of large branch institutions. Then all the banking offices, even those in the small towns and country districts, would be amenable to clearing-house control. And if the central clearing-house committees or the American Bankers' Association were made responsible for keeping the individual banks up to the mark as regards cash reserves, it is to be expected that the detail would be efficiently handled. With great branch banks in the United States the policy of giving supervisory powers to the association or the clearing-house might be expected to give better results than it does in Canada, because there would be the Government examiners to give the association or clearing-house officers information whenever any bank began to develop a dangerous situation. The Canadian association is without this information. Its officers are obliged to calculate and guess as to a suspected bank's position, as they have only the published statements to guide them.

Increased Usefulness of the Banks

Of course, while the banking business of the country is in the hands of so many thousands of small banks, a large number of them operated by men who have had no training in banking and who have no desire to master the principles of banking, it would scarcely be wise or safe to allow them a full measure of liberty in regard to their cash reserves. If that were done there would be plenty of so-called bankers who would put practically their whole resources into loans and discounts for the sake of earning large profits. The law endeavors to restrain them from

taking this course—sometimes with but indifferent success. On the other side are the thousands of bankers who are capable enough and wise enough to carry safe reserves even if the law did not direct them to do so. There is no way in which the Government can discriminate. It cannot say to the good and wise banker, "You may have liberty in this matter of reserves; the restrictive provisions are intended only to prevent the bad or ignorant bankers from endangering their depositors and the communities in which they operate." The good men, who are a majority of the whole, must be bound or restricted in order that the inefficients shall be prevented from doing harm. So that it is right and fair to count among the advantages which the United States would derive from the institution of branch banks the fact that the harmful naming of a legal minimum of cash reserve might be discontinued, and the banks of the country put upon the same footing in that respect as the joint-stock banks of Europe, Australia, and Canada.

There is no doubt their usefulness would be vastly increased and it should not be impossible or difficult to devise means whereby they would carry cash reserves ample for their safety. The removal of that legal minimum clause, combined with the granting of real rights of note issue to the banks, should bring into the available column a huge amount of cash which, though now figuring as reserve in the statements of the banks, is of no use to them whatever unless they violate the laws. At the lowest calculation several hundred millions of show reserves would be changed into a mobile asset available for use in an emergency; and there would not likely be seen the spectacle of an association of great banks in the country's financial capital suspending cash payments while they had $150,000,000 or $170,000,000 of specie and legals in their vaults.

XIV

THE SAVINGS BANK BUSINESS

THE EASTERN THEORY REGARDING SAVINGS BANKS

IN conservative banking circles in the eastern part of the United States the opinion is strongly held that the savings bank business should be kept strictly apart from the ordinary or commercial banking business. The theory is that as the wage earners and the poorer, more ignorant classes of the public, who put their funds into the savings banks, are not well equipped for making a discriminating selection of depository banks, the state should give them protection through providing laws which direct the investments of the savings banks—the institutions which they are supposed to patronize—into certain securities regarded as being eminently sound and safe. Thus the savings banks, when investing in bonds, are restricted to securities which fulfil certain severe requirements. In the Eastern states there is an honest effort made to keep the two kinds of banking entirely apart; and national banks wishing to transact a savings bank business have often taken the trouble to organize separate institutions under the form of which they might take funds for account of savings depositors. In the West and Middle West the line of demarcation between the two kinds of banking is not so sharply drawn; in that part of the Union commercial banks that operate savings departments are quite common. Possibly one reason is that the West could not so well afford to have a large part of its cash resources forbidden to its commercial borrowers.

Disposition of Savings Bank Resources

In the report compiled by the National Monetary Commission, as at April 28, 1909, the savings banks in the United States, mutual and stock, are given as seventeen hundred and three in number, and their total resources are said to have been $4,072,710,105. Of this total no less a sum than $3,506,603,927 consisted of individual deposits. The disposition of the savings bank resources was as follows: In real-estate loans, $1,620,131,446, or about 40 per cent. of the whole; in state, county, and municipal bonds, $710,159,544, or over 17 per cent.; in railroad bonds, $769,980,509, or about 19 per cent.; in United States bonds, other bonds, stocks, etc., $233,130,863, or about 6 per cent.; in loans on demand and on time against collateral, $232,893,153, or about 6 per cent.; in balances with other banks, premises, furniture, cash and cash items, and other assets, $326,170,590, or about 8 per cent. Among the items of resources the only headings under which commercial loans and discounts might be found in bulk, are: "Loans on demand, unsecured by collateral"; "On time, with two or more names, unsecured by collateral"; "On time, single-name paper unsecured by collateral"; "Loans not classified," and "Overdrafts." The total carried under those headings is $180,244,000, or about 4½ per cent. of the whole resources. In Chapter II, relating to the cost of the existing system of banks, it was shown that, taking all classes of banks in the United States, only 23 per cent. of their total resources was applied to commercial loans and discounts. The figures now given show how important is the part played by the savings banks in bringing about that state of affairs. Some of the economic effects of the policy have already been discussed.

The English Opinion

I may now devote some space to a discussion of the question regarding the necessity or desirability of keep-

ing commercial banking and savings banking religiously apart. It is worthy of note that ideas similar to those held in the eastern part of the United States have long been held in England. Twenty and twenty-five years ago the best authorities there were almost unanimously of the opinion that the two departments of banking should be kept rigorously apart. It was accepted as orthodox doctrine that the commercial banks might take deposits on current account, and that they might take deposits at interest from the people of their districts, giving receipts or certificates therefor; but it was thought improper and undesirable for them to operate savings departments and thus secure possession of the precious cash accumulations of wage earners and others in humble circumstances. For them the Government provided the post-office and the trustee savings banks. By means of these, facilities were plentifully supplied to all districts, and the depositing classes using these conveniences were given the strong security of the British Government.

Local Banks Giving Place to Branch Banks

Latterly, if one may judge from developments in the banking business, English opinion in this matter has been undergoing a change. The great joint-stock banks have begun to institute savings departments wherein they accept small deposits at interest. The critics scarcely venture to say that humble depositors trusting such institutions as the National Provincial Bank of England, Lloyd's Bank, or another of the great English banks, are in peril of losing their funds; but two or three years ago, when the movement was plainly making headway, they took the ground that a joint-stock bank transacting a savings business should keep the funds derived from its savings department customers strictly apart from its ordinary banking funds. Why it should do so I cannot see. It appears to me that if the bank invests the funds

in such manner as to be surely available when demanded, and if it keeps itself generally in such condition that it can meet all its liabilities of whatever description promptly in cash as they accrue, that is all that is necessary. English opinion is proverbially conservative. Usually it takes a long time to bring about a change of opinion on important matters. But it is quite probable that in due time even the most conservative critics will recognize that the change which has been effected in the character of English banking in the past half century has put an entirely different complexion upon the question as to whether the commercial banks should or should not operate savings departments. While the commercial banks were numbered in hundreds, while most of them were small concerns not subject to supervision from outside, it would, of course, be dangerous for all parties if the savings of the poor and ignorant were delivered into their keeping on a large scale.

Commercial Banks with Savings Departments

When a few large joint-stock banks with hundreds of branches replaced the small concerns the situation became different. Among them in recent years failures have been exceedingly rare, and as the banks continue to decrease in number and increase in size and strength, the chances of failure or of loss to depositors probably grows less. In these circumstances there is not the same necessity for a hard-and-fast line of demarcation between savings deposits and commercial deposits. In actual practice, even when it is supposed that the two kinds of deposits are kept apart, it always happens that the commercial banks get a certain amount of what are, in fact, savings deposits. The character of a deposit is not altered by issuing a certificate of deposit for it instead of a savings bank pass book. So it comes to pass that the time certificates cover deposits of workingmen and

small savers, to a certain extent, in all places where commercial banks operate.

Savings Bank Casualties

In the United States it would, perhaps, be possible to trace a connection between the Eastern conception of the savings bank business as a thing properly kept apart from commercial banking and the existence of the thousands of small local banks. For the same reasons that it was considered dangerous in England to have the small local banks act as custodians of a huge mass of savings belonging to the poorer classes, it appeared to be undesirable to have the thousands of national and state banks act as custodians of the people's savings. Therefore, in many states, special institutions were created to take care of the savings of the poor, special laws were passed to confine the savings bank investments to a few safe channels, and attempts of the ordinary commercial banks to develop a savings bank business were frowned upon or discouraged.

Now, it is worth noting that the casualties among the savings banks of the United States are sufficiently numerous, in spite of the careful legislation with which their business is surrounded. On page 69 of the 1909 Report of the Comptroller of the Currency is a statement showing that in the eighteen years 1892 to 1909 (inclusive) one hundred and fifty-three savings banks failed, with liabilities of $51,786,000 and assets of $47,717,000. It is but fair to say that sixty-eight of these failures occurred in the Middle States (sixteen in the State of Iowa alone).

On the whole, the savings banks in the East have been made reasonably safe. They fail occasionally and depositors lose money. However, apart from the question of security, it can be argued that the system has a grave defect. It cannot be made to provide anything but an

inadequate service to large numbers of wage earners and small savers throughout the country. In the localities where they are established the savings banks provide good facilities. But there are not enough of them; they do not penetrate the country districts. They are plentiful enough in certain districts of the cities and larger towns, but too scarce in the smaller places.

Mutual and Stock Savings Banks

The savings banks are of two kinds—mutual and stock. The mutual banks are largely of a philanthropic nature; they have no capital stock and are operated for the benefit of their depositors. After expenses are paid the profits belong to the depositors and are either paid to them as interest or held for their account in the form of a reserve fund. The stock savings banks are commercial enterprises in the sense that the profit from their operation, if there is a profit, belongs to the owners of their stock. Depositors are merely entitled to interest at a fixed rate. It is well known that as a field for profits the purely savings bank business is not inviting. On the one hand, it is necessary, in order to get deposits, to pay a high rate of interest; and, because there are no current accounts free of interest, the net per cent. cost of deposits must always be a figure higher than the rate of interest paid. And, on the other hand, the legal restrictions upon investments serve to force the savings bank funds into securities earning a low rate of return.

So in the one case the provision of savings bank facilities depends upon philanthropic efforts, and in the other upon an uncertain and unattractive margin of profit. There will always be thousands of small towns and villages wherein the philanthropic spirit is not high enough or strong enough to provide mutual banks and where there will never be much of a prospect of stock savings banks operated at a profit.

The Post-Office Banks

Although it is commonly understood that postal savings banks were advocated by the Republicans in the 1908 election as a reply to the scheme of mutual guaranty of bank deposits, which was put forward by the Democrats, it is quite likely that the postal banks would not have received such strong support in Congress but for the deep-seated conviction in the minds of well-informed people that facilities for saving in the rural districts will always be deficient while the present banking system prevails. There is no doubt that postal banks established in the smaller places throughout the country would prove decidedly beneficial to the farmers and workingmen.

In England these banks are everywhere, and will accept small deposits from any one wishing to pay them in. Because of the existence of the postal banks hardly any person lives more than two or three miles from a confidence inspiring depository.

In Canada also the post-office banks have served a useful purpose. All post-offices that are money order offices are postal savings banks. Until toward the close of the nineteenth century they were of the greatest benefit to the people of Canada. Now they are declining. Their decline has coincided with the great branch extension movement of the chartered banks. Since 1896 the banking offices in the Dominion have more than trebled in number. At the present rate of increase they will have quadrupled in a short time. The meaning of this is that in hundreds of places where prior to 1896 the post-office was the sole depository there are now chartered bank offices eagerly competing for the savings of the people.

Chartered Banks versus Postal Banks

Although the post-office banks and the chartered institutions pay the same rate of interest—3 per cent.—

the latter invariably draw deposits from the post-office wherever the two are in competition. The reason is that the chartered banks offer superior facilities.

In order to operate the post-office banks economically it is necessary to centralize the bookkeeping and clerical work at Ottawa. The hundreds of postmasters who accept deposits from the people have nothing to do with the books or the investment of the funds. When a deposit is received the postmaster merely enters it in the customer's passbook and sends the cash to Ottawa. When he wishes to withdraw part or all of his funds the depositor goes to his local postmaster and signs a requisition or withdrawal order for the sum he desires to withdraw. The postmaster sends it to Ottawa, and in the course of a few days a Government check on the Ottawa branch of the Bank of Montreal will be received by the depositor, who thereupon takes his check to a chartered bank and gets the money.

If the business were done in another manner—if, for example, the ledgers and other necessary books were kept at the post-offices, and cash provided to enable the postmasters to pay withdrawal checks immediately on presentation—the expense of conducting the banking operations would rise to prohibitive figures, and in all probability there would be numerous defalcations discovered every year. Thus the enforced delay of two, three, or more days, when a depositor undertakes to withdraw his money, is something that cannot well be obviated. Because of it, and because of the other minor inconveniences of dealing with a Government bureau, the general body of depositors prefer to use the chartered bank branch. Their experience in the past twenty years has been of a nature to cause them to consider that when deposited with one of the large branch banks their savings are practically as secure as if held by the Government. In consequence there has been seen a steady transfer of balances from the post-offices to the ordinary banks, in

the course of which the deposits held by the Government have latterly been falling at the rate of about $1,500,000 per year, notwithstanding that the accounts have been credited with some $1,700,000 per year for iuterest.

Decline of the Canadian Postal Banks

People who do not understand the real reason for the decline in the deposits held by the post-offices speak of it as an unfavorable development, or as something to be deplored; but all who understand the true cause of the movement and its effects regard it with undisguised satisfaction. It happens because the facilities supplied by the chartered banks are, in the estimation of the public, superior to those supplied by Government, and because there is not a wide or very noticeable difference between the credit of the larger banks and that of the Government. When the banks acquire possession of deposit funds which the Government had been carrying the funds become at once available to the country retailers, farmers, live stock buyers, and produce buyers, manufacturers and wholesale merchants, who wish to borrow. While the funds are held by the Government they are invested, except the cash reserve of 10 per cent., in public works and buildings, subsidies to railroads, and the other customary governmental expenditures; they are not available to the commercial classes for borrowing. If all the balances were transferred from the Government to the banks (they amount to a little less than $57,000,000) the latter institutions would probably carry against them a reserve of approximately 25 per cent.—about half in cash and half in call loans, securities, and bank balances. As they are inactive accounts they require a smaller reserve than do the demand deposits or current accounts of business customers. There would thus be left an amount, approximately $42,500,000, which would be held subject to the borrowing demand of the agricultural,

mercantile, and industrial interests of the country; and the tendency of the change would be either to cheapen the cost of bank loans in general or to provide a more generous supply of funds during a stringency. If normal conditions prevailed in the world's money markets it is altogether likely that the Government of Canada could borrow in London the funds required to pay off the depositors in the post-office at a less cost than that to which it is now subject. Of course this is a purely hypothetical proposition. The Canadian bankers have no very earnest desire to have the Government hand over to them its savings bank balances. The wiser ones among them recognize that the postal banks are not formidable competitors for the new deposit fund created each year, and that it is well to have a depository of that kind in which timid women, old men, and ignorant foreigners can take refuge.

Postal Banks in the United States

Any estimate of the probable effects of the institution of postal banks in the United States requires to take account of the important differences in the conditions prevailing respectively in the United States and in Canada. The most important of these differences is that relating to the establishment of banking offices in the small places. If post-office banks of the Canadian pattern are provided they will constitute in thousands of little villages the sole respectable depository available to the people, and it is certain that they would be utilized extensively.

Another important consideration is that owing to the smallness and lack of prestige of the ordinary banks the average depositor would not be disposed, as he is in Canada, to regard the two classes of depositories as nearly equal in point of security. In other words, the credit of the post-office banks in the United States would

be distinctly superior to that of the ordinary banks, whereas in Canada the difference is not marked.

Owing to these two considerations it seems inevitable that the post-office banks would accumulate a very large total of deposits; and no doubt a part of their accumulations would be at the expense of the ordinary banks.

Two methods of disposing of the funds were considered: The first was for the Government to redeposit the funds received at each post-office in banks, national and state, operating in that district or locality. In this way the funds were to be kept in the locality to which they belonged. The other method was to give the Government the right to invest the funds in Government bonds in time of war and when the public credit was otherwise threatened.

Postal Banks May Promote the Branch Bank Idea

There are grave objections to be urged against either plan. If the funds are redeposited in commercial banks in all localities it is certain that many banks will be unable to return the deposits when demanded. And if the funds are invested in Government bonds it means that a huge additional sum of cash resources will be placed beyond the reach of the commercial classes. The whole question of the effects to be produced by the postal banks is doubtful or obscure. It would be much easier to trace the probable effects if there were branch banks in operation. Indeed it would not be at all surprising if the institution of postal banks gave an impetus to the movement for branch banks. It may well be that the bankers of the United States will find that the only way for them to compete effectively with the Government for small savings deposits is for them to convert their small single-office banks into branch banks and thus raise their prestige in the eyes of the people and at the same time push their offices into the smaller places.

When Savings Funds Are Used in Commercial Discounting

As an argument for allowing large branch banks, devoted to commercial banking, to operate savings departments, it can be urged that as a whole the mass of funds they would accumulate in that way would be peculiarly adapted for use as advances to mercantile and industrial borrowers. As every banker knows, the aggregate of savings department balances of a bank enjoying continuously good credit tends to increase steadily from month to month and year to year. They possess a degree of permanence qualifying them eminently for use in granting credits to the business interests which require steady support throughout the year. If it be said that the diversion of a huge mass of the savings bank fund from bonds into commercial discounts would embarrass the municipalities, railroads, etc., which now secure necessary funds through the sale of their securities to the savings banks, it can be replied that if the banking facilities of the country were entirely adequate there would be an economizing in security issues by industrial and other companies, because they would be able to finance their requirements more largely by means of bank advances. Many corporations now issue bonds, paying interest thereon from year end to year end, and carrying a large part of the proceeds in hand, not earning any revenue for a portion of every year, where they would, i' they might go to a large bank and negotiate a loan of two or three million dollars for five or six months, depend upon bank accommodation and effect a notable saving in interest charges. It can be said also that branch banks would, as a matter of course, invest a certain proportion of their deposits in the classes of bonds now purchased by the savings banks. Possibly it would be necessary for issuers of high grade bonds to have a larger recourse to Europe. It should be remembered that under a sys-

tem of large branch banks it would come about, in all likelihood, that the banks had more or less always a formidable "call" upon the gold resources of London, Paris, and Berlin. They would find it conducive to financial stability in America to carry a respectable part of their available reserves in the form of European demand loans, bills, and balances.

The Credit of the Branch Banks

Possession of the right of uncovered note issue, utilization of the surplus or unnecessary cash circulation of the country, and the massing of reserves at the centres should enable them to do this without at all injuring American borrowers. As under the present system Europe is under the necessity of making large advances at call and at short date to the New York market, a reversal of position might set free a considerable amount of European capital which would be available for investment in American bonds.

I have dealt elsewhere with the matter of the security or safety of the depositors. There is reason to suppose that branch banks of the type of the Bank of Massachusetts and the Bank of Minnesota, subject to the conditions and regulations I have detailed, would offer humble depositors a better security than they now have. After a few decades of clean and honorable attention to the financial and commercial interests of the country their credit should be so nearly equal to that of the Government that they might be expected to attract practically the whole deposit business wherever they established branches. So in this way the branch institutions, provided they had the privilege of issuing uncovered notes to serve as currency, and the unquestioned right to operate savings departments in connection with their ordinary business, could be expected to supply facilities, the most adequate to the less important localities.

I wish, however, to emphasize my statement that in order to give the country people the fullest measure of

benefit the banks would require both the right of issue and the right to operate savings departments. Possessing both, they would find profit in placing branches at small hamlets with only a few business establishments. At many such places the savings bank business of the farmers would be almost the sole attraction. I have already explained how important a factor is the right of issue in inducing the banks to open and maintain branch offices.

An Agreement Regarding the Deposit Rate

A feature of the savings-bank business of the Canadian banks which I have not yet dealt with may with propriety be discussed here. It is the uniformity of the rate of interest paid. From the Atlantic to the Pacific the chartered banks of Canada quote 3 per cent. as the maximum rate of interest on deposits. The rate has not varied for over ten years. In periods of ease and periods of stringency it has been the same. Naturally this uniformity has led to accusations of monopoly. Parties unfriendly to the banks say that a great monopoly exists, and that through the Bankers' Association the people are held in an iron grip. It is also said that a few bankers in Montreal and Toronto control the banking business of the whole country. I admit that the branch system tends to concentration of banking power; and where there is concentration of power the argument of monopoly is usually raised. For example, the *London Economist* in a recent half-yearly review of banking statistics, after mentioning the steady reduction in the number of banks in England and Wales, points out that a few gentlemen in London control 80 per cent. of the banking resources of the country.

Wide Distribution of Stock Ownership

A statement of this kind made in reference to the banks is apt to convey an erroneous impression unless it is ac-

companied by certain explanations. On hearing it an unlearned reader might suppose that the gentlemen in question exercised their control by virtue of stock ownership or of some proprietary right resident in themselves; whereas, in fact, that is not the case. The gentlemen wielding the power referred to are either the hired servants or the representatives in trust of democratic bodies of proprietors. In the cases of the British joint-stock banks, and of the Canadian chartered banks, the stockholding is widely distributed; and the directors do not, as a rule, hold office because of a preponderating ownership of voting power. The circumstance must always operate to mellow the effect of the concentration of power. I have indicated how the same conditions might be ensured for branch banks in the United States. Everybody who has had experience in the banking business in Canada is aware that the slow reduction in the number of the banks has not lessened the banking competition. Though it may truthfully be said that a few banks (sixteen or seventeen) control the bulk of the banking resources of the Dominion, it is also a fact that those few institutions are constantly engaged in the keenest competition among themselves. They agree to pay a uniform rate upon deposits; but the man who argued from that that there was no competition for deposits would be entirely wrong in his conclusion. There is competition, and it is of the sharpest kind. Any person having access to the branch correspondence in the head office of a large bank would find that from branches in every part of the country there were bitter and endless complaints about the activity of competitors.

Competition in Establishing Branches

Each branch manager knows that one certain way to improve his personal prospects is through building up the good business of his branch, both deposits and loans.

He always has a covetous eye for the business of other banks in his locality, and often enough he goes beyond the bounds of decency in his efforts to get a good deposit or a good discount account. He may not offer a higher rate of interest for the deposit, but he can and does offer other things which have the same effect. He will collect at par or perform without charge other services for the customer. Even if the Canadian banks were reduced to a dozen or fifteen all told, it is strongly probable that they would be engaged in ceaseless competition at all branch points. At the present time there is one kind of competition particularly in evidence. It is the competition to establish branches. Whenever a new town is started in the West there is a race for the point. Sometimes two or three banks will open in a very small place. Many of these branches are operated at a loss for a considerable time.

Healthy Competition Ensured

To me it seems that there would be a greater likelihood in the United States than in Canada of branch banks maintaining an energetic and beneficial competition. The existence of thirty or forty very powerful banks meeting each other at many different points should ensure the keenest competition. And instead of thirty or forty banks there would probably be two hundred or more. They could not make excessive profits without drawing new banks into the field. The minimum capital for new banks with note circulating privileges might be placed high enough to ensure that only strong institutions would be chartered, and yet not so high as to make it difficult to organize new banks in case an excessive rate of profit accrued to capital invested in banking.

XV

FOREIGN TRADE AND INTERNATIONAL STANDING

Position of the United States

IN his address on "Abnormal Features of American Banking," delivered at the Denver Convention of the American Bankers' Association, Sir Edmund Walker, the well known Canadian banker to whose utterances I have already referred, discussed the necessity of reforms in the banking system of the United States. Toward the conclusion of his speech he said it was desirable that such species of banking as was introduced should be able to create, among other things, a condition under which "a great international banking business might be created, and you may do justice to your overseas possessions, to the great ports of export and import, to your mercantile marine, and to your position among the great nations of the earth." While dealing with this department of the subject, I cannot forbear quoting the remarks of Mr. S. D. Scudder, of the International Banking Corporation, New York City, before a bankers' association meeting a few years ago. Mr. Scudder's address was on the subject of "International Banking," and he defined it as understood in its true commercial sense to be "those facilities which aid in the financial settlements necessary for the exporting abroad of local products and the importing of foreign goods."

How London Levies Tribute

In order to illustrate the conditions now prevailing he gave the following example:

"I have friends in a foreign port who would gladly procure there, if they could, some exchange in dollars with which to pay for goods bought from their Boston house. But that foreign country sells and exports annually so small a quantity of merchandise to the United States, because of our prohibitive tariff laws, that no such exchange is to be had, and thus it happens that settlements, even for goods imported there from the United States, must be made through London. My friends settle with their own house in Boston by purchasing pounds sterling drafts on London. The Boston people, when they receive these drafts, then sell them to a foreign exchange banker for so many dollars. Thus London gets a tribute on business which never originated there, on goods which never went there, and on a settlement which but for our prohibitive policy would naturally have been made direct. Is it not clear that we Americans must stand all the loss on such transactions? Is it not plain that in quoting competitive prices this tribute abroad must be taken into consideration?

"You may ask: If an American bank or its branch were located there, would Europe still collect this tribute? I reply: Yes, under our present prohibitive trading laws the larger proportion of all commissions must necessarily go abroad; because in the absence of sufficient export trade from such a place to the United States any American bank or branch there would itself be compelled to settle with its United States head office through Europe. The inverse argument also holds good in such a case. Wherever such a foreign country is disposing of, or, we will say, clearing, most of its foreign goods, there also it will likely purchase most of its wants. And so it happens that London and Paris and Berlin are to-day capturing the world's most profitable trade, and levying their banking tribute on every portion of it, because of laws permitting their own merchants to trade and barter in the markets of the world. Leave the banker entirely out of

the deal, and see how it works with the exporter who is rich and does not have to borrow. Supposing for the cotton you take abroad it were permitted to bring back some goods to be sold here at a reasonable profit, wouldn't your cotton shipment and the money it represents be 'earning its way back,' so to speak? But our high protective tariff forbids the importation, and so you are compelled to ask that gold be sent back, not only at a great cost and loss to you in dollars and cents, but also in ultimate loss of trading opportunity with the people to whom you have been selling your cotton."

The Foreign Bankers in New York

In the foregoing quotation the matter of the tariff overshadows the purely banking part of the question. I do not intend in this work to discuss tariff questions. However, I have included the whole quotation because of the co-relation of the subjects. I give the following further excerpt from the same address by Mr. Scudder, because of its pertinency to the matter under discussion:

"Although an American by birth and long ancestry, I had the opportunity of getting my initial financial education in an English, or, rather, in a Canadian bank. Very often in those days, while trying to grasp the meaning of that great world's business which was being done by the Bank of Montreal and similar institutions of foreign origin, I wondered why no large home organization then existed in the United States which was especially fitted for work pertaining to those transactions daily taking place between merchants of the Old World and those of our own country. I thought it strange that while every leading nation of the world had branch banks or banking representatives here, not one of our financial institutions was at that time represented abroad. It was a constant source of astonishment to me that the American mer-

chant and the American manufacturer had not that financial backing abroad which was vouchsafed to the business men of other lands by their own banks. Not that there was any scarcity in the United States of private firms and banks engaged in international banking; but I found that almost without exception these firms, and even the banks, either were of foreign origin, possessed a foreign partnership, or else represented on this side some foreign bank or banking house. At the same time it was strongly impressed upon me that by far the larger proportion of all strictly commercial international transactions on this side pertained to exports and not imports. And so the conviction came, and I think it is entirely correct, that the reason for the existence in our land of these great foreign banks and foreign private houses was primarily because of the staple export trade which we were furnishing to those countries."

Usefulness of Foreign Branches

From this last paragraph it is possible to get some idea as to the services performed for the trade of their own country by bank agencies or branches established abroad. Again resorting to Canada's case, it will be seen that many of the important banks are represented by a number of branches in foreign lands. Canadian bank branches and agencies are found in Newfoundland, the Bermudas, the United States, Mexico, Cuba, Porto Rico, the Bahamas, and London, England. One may well understand that these agencies, wherever they exist, are potential factors in building up Canada's foreign trade, in extending her good name, and in attracting capital to the Dominion, while at the same time doing a useful service in discovering profitable investments abroad for Canadian capital. No matter in what forms the commercial and productive activity of these foreign peoples finds expression, the men in the Canadian branches are certain

to be thoroughly informed about the whole. They also bring with them a reasonably full knowledge of the various goods which the different provinces of the Dominion require to buy or sell abroad. Loyalty to Canada, to the banks employing them, and to the localities in which they are situated impels them to open new channels of trade with the Dominion when such a course is likely to result in mutual profit for the trading nations. It should be observed here that usually the establishment of the banking facilities follows the establishment of trade rather than creates it. For example, it is the banking institutions especially identified with the Province of Nova Scotia that have established the branches in the West Indies. It is easy to trace the course of events that induced them to take that step. They were called on constantly to finance for their customers, the West India merchants of Halifax, large transactions involved with the importation of sugar, tobacco, rum, and other tropical products, and with the exportation of Canadian fish and other products. With no branch establishments in the West Indies they enjoyed only a part of the profitable exchange business resulting from this trade. With branches established at the principal tropical export centres they might hope to have practically the whole of it. Negotiation of bills of exchange drawn against exports to Canada would almost certainly fall to them. Also the accounts of Canadians resident in the tropics would naturally gravitate into their ledgers. After the branches were opened it transpired that the banks secured a large share of remunerative business outside the Canadian trade. Thus the Royal Bank of Canada was made the intermediary for paying off the Cuban troops when they were disbanded; and it and the other Canadian banks now negotiate an important share of the exchange resulting from shipments of tropical products to the United States, to Europe, and other parts of the world.

Foreign Branches a Good Advertisement

Furthermore, the foreign branches serve as a valuable advertisement for the Dominion. The people of Cuba, of Mexico, and of other foreign countries are impressed with the idea that Canada is a wealthy and important country when they note that she establishes branch offices of great banks in their principal cities and trading centres, that she sends out clerks to man and operate them, and provides capital to carry on a large share of the local business. When they consider that in this respect of providing banking facilities for them Canada is equal or superior to the United States—notwithstanding that the latter country is nearer and far more populous and wealthy—their opinion of the banking machinery and resources of the Dominion must be highly favorable.

United States Banking as It Appears to Foreigners

There is yet another respect in which the non-branch system of banks handicaps the United States in acquiring a high standing abroad. When, in the course of their business operations, the great bankers of Europe have their attention drawn to United States banking, they do not see it in the light of the large totals—many billions of dollars—representing the aggregate of the country's banking resources. In the ordinary course the banking system of the United States comes before their notice in the form of drafts and obligations of the individual banks. Of these there are some few in the large cities the standing of which is well known. But of the great majority the European bankers know little or nothing beyond the fact that their names are to be found in the banking directory, which may also contain a list of the principal executive officers and perhaps the amount of capital and surplus and a few items of the balance sheet. This by itself conveys practically no information to the foreign

banker's mind as to whether the various institutions are sound or not. He knows very well, if the document he is required to act upon is a draft on New York or a check on that or another American centre, that the drawer or drawee bank may fail before collection can be made. He knows that there is a constant succession of failures, and, as likely as not, he has himself been involved in the failure of small United States banks from time to time. Also, while the New York City banks and the banks in the other principal centres are well informed about and careful to observe the various European usages and customs having to do with financial transactions, there are a great many bankers in the interior who transact their European business and their foreign exchange business either ignorantly or carelessly, and create endless trouble and annoyance for their foreign and New York correspondents. Of course, under a system of branch banks the dealings with European and other foreign countries would be carried on under careful regulations and instructions. Probably all drafts and documents would be passed through a central branch which possessed officers and clerks thoroughly familiar with foreign usages and customs.

United States Bank Drafts

To illustrate how the existence of small banks in such large numbers affects the American standing abroad I have mentioned Europe, but it is not necessary to go so far afield. A good illustration can be had by noting the practice of the bankers in Canada as it relates to drafts and checks of United States banks. In my several years' experience in active banking in Ontario and in western Canada—covering service in the teller's box and as branch manager—I was frequently called on to deal with parties presenting drafts on New York drawn by banks in various parts of the United States.

Of course, when they came to the counter in the deposits of the regular customers the drafts would go through without discussion. With the authenticity of the documents and their ultimate payment guaranteed by the local depositors there were no reasonable grounds for questioning them. But when presented, as they often were, by strangers or by individuals not possessing any means or credit, the case proved somewhat different. Then to cash the draft meant to advance money solely upon the credit of an instrument purporting to be the obligation perhaps of a small bank in Colorado or New Mexico about which nothing whatever was known. In all cases of that kind there is, of course, the risk of forgery. The draft may not be the thing it purports to be. As I shall explain in the subsequent paragraph, the risk of forgery is greater in handling drafts drawn or purporting to be drawn by banks of the United States type than in handling drafts emanating from large branch banks. Apart altogether from the consideration of a possible forgery the situation is perplexing enough. The holder of the draft offers to procure identification, so there is no trouble on that score. The amount is $200. What is to be done? You say to the payee: "We know nothing of that bank in the Western states. It may fail before we could get our money back. So we must ask you for an endorser as well as for identification." This position is perfectly consistent with sound banking principles. Although a bank might continue cashing such drafts unendorsed without experiencing losses the risk is surely there, and it is altogether disproportioned to the benefit secured by the bank through cashing the drafts. It is the duty of the branch officers and employees, and they are so instructed in the code of rules, to avoid subjecting the bank to any risk at all in dealing with casual customers. Hence an endorser is necessary unless some reliance can be placed upon the payee.

Branch Banks Would Improve the Country's Standing

The case would be different if there were in the Republic a comparatively small number of large branch institutions. Then the foreigners could without much difficulty keep themselves informed regarding the individual banks. And it is reasonably certain that every United States branch bank that had occasion to remit money frequently to a foreign country would have an arrangement with an important bank in that country the officers of which would feel honored by being selected to act as correspondent. The branches of this correspondent bank would be instructed to accord every respect to the drafts and orders that were presented at their counters. In this case, too, the risk of forgery would be greatly reduced, for the United States bank would furnish the foreign bank with complete sets of specimen signatures of officers authorized to sign on its behalf; and every branch of the drawee bank would thus have the means of comparing the signatures on the documents presented with the specimens in the signature box. Unquestionably United States banking would, under these circumstances and under others which would be introduced with branch banking, rise appreciably in the estimation of foreigners near and far.

Fluctuations of the Interest Rate

I have already pointed out that with the business of the country in the hands of large branch banks the destructiveness of panics would be materially lessened, and that a practical immunity from panics might perhaps be enjoyed. Also it is but reasonable to expect that the operations of branch banks possessing rights of note issue against general assets would entirely do away with those extreme fluctuations in the interest rates at New

York. Eminent financiers have at different times characterized those 10, 20, 50, and 100 per-cent.-interest rates as a national disgrace. It might be said that they represent only one of a number of disgraces for which the system of isolated small banks and rigid currency is responsible. There is excellent ground for believing that with a system of banking and currency such as I have outlined, in good working order, a higher rate than 7 or 8 per cent. would never be seen in the American metropolis. For during the fall season the banking institutions would not be compelled to force a large mass of credits from one set of borrowers in order to place them at the disposal of another. They could provide the bulk of the funds necessary for the special work of the crop moving through calling into being an extra amount of currency which could remain in existence only while there was work for it to do. It is well known that the urgent bidding of stock market borrowers whose credits are taken away has much to do in bringing about the erratic fluctuations in the interest rate.

How the Skilled Financiers Profit

The two things—the panics and the extreme fluctuations in interest—have some considerable effect in causing a certain class of European investors to be cautious in dealing with the United States. Many of them look upon it as a field to avoid, because of the danger of being caught in a panic or semi-panic. The financial instability and the tendency of money rates to rise on occasions to very high levels have their effect, of course, in producing violent fluctuations in security prices. From the present order of things the skilled bankers at the centres and the foreign banking institutions interesting themselves largely in United States financial matters are able to extract good profits. They benefit through the high rates of interest prevailing in the fall of the year and in other seasons

during which monetary conditions are upset or subject to great strain. Their experience and position also enable them usually to extract profit from the fluctuations in securities. Mr. Andrew Carnegie is reported as saying that if he had wished to make some money he could have made $50,000,000 in the 1907 panic, as he had the necessary cash and conditions were ripe. One may easily believe that he could have done so. It strikes an outsider that it is quite time to consider the abolition of a banking system which creates conditions permitting the great capitalists to exploit the unlearned and ignorant in such wholesale fashion. The extra profits made by lenders of money and by wealthy operators in securities represent, of course, special expenses for the borrowing classes and losses for thousands of humble speculators and investors.

Foreign Bankers Finance Domestic Business

In connection with this matter of international standing it should be borne in mind that, under the conditions presently prevailing, foreign banking institutions finance a large part of the foreign trade of the United States. They also take a rather important part in financing the domestic business of the country. Thus, in connection with the cotton trade, the foreign bankers not only buy a large proportion of the bills covering exports of raw cotton, but I understand that they advance funds extensively to facilitate the purchase of the raw cotton from the farmers and the movement from the fields to the seaports. One might expect that in a country so large and wealthy as the United States the native banks would perform that service without assistance.

Also three of the Canadian banks assist materially to finance the business of the Pacific Coast, through the operations of their branches in San Francisco, Seattle, and Spokane. When it is considered that they have built up large discount and deposit businesses at these points,

in competition with United States banks possessing strong local boards and affiliations, and endowed with all the advantage pertaining to home institutions, it seems fair to conclude that their success is chiefly due to the deficiencies of the system of small local banks in regard to caring for their own home industries and trades.

New York as Banker for Other Nations

On one or two occasions in the past decade New York participated with London and other European centres in bringing off some international loans. Thus a portion of the British Government loans during the Boer War was placed in New York. Japan borrowed in New York during the war with Russia; and both Russia and Germany have placed an amount of bonds with American bankers. When these transactions occurred there was discussed the probability of New York wresting from London the supremacy in world-finance which the British metropolis had held for so long. It now appears as if New York's participation in important international issues of securities at that time resulted merely from the fact that money conditions in the American metropolis happened then to be such as to permit that course being followed. Since then New York has not rivalled London or Paris in world-finance of this kind. True, a few South American issues come to New York, and a large amount of capital has gone into Mexico, but the bulk of the requirements of the outside world are filled in London and Paris. There is no doubt that British trade has benefited tremendously from the foreign lendings of British capitalists and investors. It is commonly supposed that the United States has little capital to spare for loans to foreign governments and corporations. But I venture to assert that if the country had a modernized banking system that would do away with the unscientific and wasteful use of cash resources, and utilize the cash wealth

of the country as it should be utilized, it would be found that there was enough capital in New York to permit participation in good foreign loans to a much larger extent than prevails at present. And that would mean, as a matter of course, that much of the proceeds of these loans would be expended in the United States, to the great benefit of the export trade and the working classes.

The Banking Business of Mexico and the West Indies

As I have mentioned, it is in the countries and islands, near and far, with which the United States trades, and with which it has important financial dealings, that United States banks are noticeably absent. There is one New York institution—the International Banking Corporation—which has been active in extending its operation in the Far East. Its Eastern branches are, of course, controlled from the head office in New York City. There are a few banking institutions in the West Indies and Mexico which are owned in the United States. However, they are not branches of United States institutions, and in most cases their titles do not indicate clearly that they are of American origin. Of course, the reason for the non-representation abroad is that the branch idea is under the ban of the laws and regarded with hostility by a large part of the people.

Now let us picture the conditions that would likely prevail in this respect if there were in the American Union one hundred, or two hundred, or more, powerful branch banks operating under kind but firm laws and enjoying the confidence of the people. To make the picture more perfect let us suppose that pressure of public opinion has produced a sensible lowering of the tariff wall, and that it is possible for vessels carrying American goods to other countries to secure return cargoes which will be admitted through the customs at United States ports at moderate rates.

Branch Banks Would Assume the Domestic Business

The banks would then, first of all, proceed to take upon themselves the whole duty of financing the country's internal trade and industry. They would provide the cash required for paying the producers of cotton, and would carry the staple through its different stages. In the case of that destined for home consumption they would see it to the mills—in the South or in New England; they would advance the money necessary to enable the mills to pay for it and hold it; and finally negotiate the bills drawn by the mills or their selling agents upon purchasers of the manufactured cotton goods. And, in the case of raw cotton destined for export, they would see it to the seaports and buy the foreign bills drawn upon the European markets by the exporters. The same with wheat, corn, lumber, coal, tobacco, fruit, and other products. By means of their branches the home banks would facilitate production and interchange at all points where production and interchange took place. Each banking institution could by itself finance its due share of the movement of the great staples from producer to consumer in the case of those consumed at home, and from producer to foreign purchaser in the case of those exported. I hazard the opinion that if there were great commercial branch banks that would carry the accounts of small dealers and buyers, and assist them to export if necessary, there would not be so much danger of important producing industries falling into the hands of trusts and combinations.

Extending Into Foreign Countries

If there were great banks, such as the Bank of Massachusetts, the Bank of Minnesota, and the Bank of Georgia, hereinbefore described, growing rapidly each year in numbers of branches, in resources and power, they would, assuredly, as soon as they were well established at home,

extend their operations into outside countries. There are three important fields into which they would naturally extend at the outset—the West Indies, Mexico, and South America. The trade of their country with all of these is very large, and with a lower United States tariff it would grow very rapidly. There would be many bills, drawn by United States exporters, to negotiate; and many bills drawn abroad upon United States importers. The branch banks would be desirous of a large participation in this business. By establishing branches in the principal trading points in Mexico, the West Indies, and South America they would doubtless get a good deal of it. In all probability they would also develop into formidable competitors with the English, German, and Canadian banks that now transact so large a share of the general international business of those countries. And it might thus come about that the United States would draw a regular tribute from the trade of foreign lands.

It should not be supposed that in establishing these outside agencies the banks would be diverting to the service of alien nations funds needed at home. As conditions are now a large aggregate of balances owned by United States firms and agents in these outside places is carried on deposit with foreign banks. Much of this total would be transferred at once on the opening of branches of American banks. The foreign branches would thus have deposits as well as advances. And it might transpire that not a few of the banks operating abroad would do so entirely on funds acquired abroad, without using a dollar of their home resources.

United States Banks in London

The more important of the branch banks would, of course, have offices in London. They would be found in China and Japan, and perhaps in India. In short, they would do a world business. Nowadays when Americans

are travelling abroad they are obliged to be on the defensive in discussions of banking matters. For the frequent destructive panics and the periodical monetary disturbances they must offer apologetic explanations. Also when they visit London they may see great banks belonging to the various nations creditably represented. They may notice that Canada is well represented by the Bank of Montreal, the Canadian Bank of Commerce, the Bank of British North America, and the Royal Bank of Canada. But no United States bank is to be seen. If on entering the city they were confronted with the names of a number of great banking institutions belonging to their own country, displayed over creditable buildings, they might perhaps find satisfaction instead of humiliation in thinking of the representation of their banking power abroad. Their satisfaction would be heightened by the knowledge that these banks of theirs, which carried their names so proudly in the world centres, were engaged in financing an honorable share of the world business passing through London.

The Rightful Place Among the Nations

When branch banking had got well under way there would be, it is needless to say, some very large institutions. In all probability the largest of them would, in point of banking power or resources, excel most of the great banks of Europe. Powerful banks such as these would desire to have their business in a world centre like London housed in buildings that were in keeping with their prestige and standing at home. At present, so far as banking representation is concerned, Canada outclasses the United States in London. The Canadian banks I have named have creditable buildings in the heart of the city, and it is probable that two or three of these banks possess an influence or importance in London superior to that of any bank in the United States.

XVI

THE TREASURY'S BANKING BUSINESS

The Functions of the Sub-Treasuries

IT will be well, at this point, to deal with the relations of the national Government with the banks, and to discuss the question of the treasury's banking operations. I am aware of three different methods of conducting governmental banking business.

First, there is the method in vogue in the United States wherein the Government, through the several sub-treasuries, retains the custody of a large part of its own cash and acts largely as its own banker. It also selects a large number of banks to act as depositories, but exacts specific security for each deposit of national funds which it confides to the banks. In the past it has happened frequently enough that heavy collections of revenue and the sequestration of the funds in the treasury vaults operated to distress commercial and other borrowers very considerably, through causing stringency in the money markets. This distress the treasury officials have endeavored to alleviate through increasing the deposits of Government funds in banks. For governmental disbursements checks are drawn on the sub-treasuries, and every day the sub-treasuries and banks exchange items, differences being settled in specie or legals. As the system is familiar to banking and financial readers, it is not necessary to describe the functions of the sub-treasuries in detail.

The Medium of a Central Bank

Secondly, there is the method in vogue among the principal European nations which is briefly to commit the governmental banking business to a central bank. As the several countries follow somewhat different methods, I shall sketch the outlines of the scheme of the relations between the Government and the central bank as existing in England, France, and Germany. In England the Bank of England is banker for the Government. The original capital of the bank was invested altogether in advances to the British Government. In return for this, and for its management of the public debt, the bank was given certain valuable privileges, the most important of which is the practical monopoly of note issue in England and Wales. Mr. Edward G. Lowry, in his *Foreign Banks and Financial Systems*, gives the following description of the specific services it performs in connection with the management of the national debt:

"(1) The entire conduct of all operations incidental to any issue of stock; (2) the keeping of the stock-ledgers and transfer-books relating to inscribed stock; (3) the issue of stock certificates to bearer; (4) the preparation and payment of dividends on stock, and the payment of stock-certificate coupons; (5) the issue and payment of treasury bills and exchequer bonds; and (6) as depository of the public funds it keeps the banking accounts of the various Government departments, receiving money, paying drafts, and holding securities, as in the case of ordinary banking accounts.

"It facilitates the transmission of revenue moneys from the provinces and acts as the medium for the issue of gold and silver coin, and for the withdrawal of light coin from circulation. It also grants temporary advances to the Government in accordance with regulations sanctioned by Parliament."

The Bank of England

The stock of the Bank of England is owned by ten thousand shareholders. The shares are of the par value of £100, and a holding of five shares is necessary to enable a shareholder to vote. But he cannot have more than one vote, no matter how much stock he acquires. So there is no danger of a restless and ambitious financial clique obtaining control of the Bank of England. It is said that while its handling of Government business constituted its most important function in its early days, that duty is now relatively less important than its functions of banker to other banks and custodian of the national gold reserves. The British Government has no ownership of the bank's stock, and it does not exercise any control or supervision over its operations. Neither does the Government force the bank to divide its profit with the state.

The Bank of France

The Bank of France has thirty thousand shareholders. Its main function is to act as banker for the French Government and for other banks, but it also deals directly with the public at all its branches, accepting deposits and discounting bills for every one who has an account with it. Although the Government has no ownership of the bank's stock, it keeps in its hands the appointment of the governor and the two sub-governors. Also the Government chooses the names of the managers of the branches from lists submitted by the governor of the bank. Mr. Lowry thus describes its functions as banker to the Government:

"The bank acts without remuneration as the cashier of the treasury, whose accountants can all pay in or draw upon the account of the treasury in all the establishments of the Bank of France, the latter making, with-

out charge, the necessary transfers in order to centralize all these operations for the account of the treasury in Paris. In 1897 the bank was obliged, in addition, to assume all the expenses of transportation necessary to furnish the country with the different kinds of coin, to furnish the necessary service for the issue of treasury bills, and to pay the coupons of public securities at the same time as the Government *caisses*. All these services are rendered by the bank without remuneration. The French Treasury does not have a deposit in any other bank than the Bank of France."

Although the bank is not paid directly by the Government for its services, it gives them, as everybody knows, as the price of the Government deposits and the monopoly of note issue it enjoys.

The Bank of Germany

The Bank of Germany also is privately owned, the shares being distributed, like those of the Bank of England and the Bank of France, in small lots. Regarding its control and management, Mr. Lowry says: "The Government owns no shares. The management is so constituted that the Government has actual and final control."

Regarding the disposition of the profits, Mr. Lowry's pamphlet says: "The profits of the shareholders in the Reichsbank are severely limited. After 3½ per cent. is paid to them, the Government receives three-fourths of the net earnings. As its share of the profits of the Reichsbank the German Government received in 1907 something over $8,500,000. As the Reichsbank, though privately owned, is under the final control of the Chancellor of the Empire, it inevitably enjoys close fiscal relations with the Government. It is the sole depository of Imperial Government moneys, and all Government ex-

penditures or interest on the public debt are made through it. This service is rendered without direct compensation."

However, it is the case that the Reichsbank has a practical monopoly of note issue in Germany, and in that manner it is supposed to get some recompense for its services to the state.

The Central Bank's Compensation

Reviewing these three systems, it is to be noticed that in all three cases the Government has placed upon the central bank the duty of handling the national finances. Not one of the governments referred to issues notes to serve as currency, and therefore none of them is obliged to carry a specie reserve against note issues. I wish to draw attention especially to the tendency exhibited by these principal European nations to exact the performance of onerous or important services from the central banks, and either to abstain from reimbursing the banks or to compensate them through conferring upon them some privilege or advantage not enjoyed by other banks in the same country. The banks are expected to place their resources freely at the Government service. The system is undoubtedly beneficial to Government finance. It has been of great value in assisting those European nations to finance wars and large military and naval expenditures. And there is no doubt that the United States Government, by creating a central bank, might facilitate issues of its bonds, and perhaps it might, like the German Government, force a share of the profits made by the central bank into its own coffers. But it appears to me that there should be other considerations taken into the account. The convenience of the Government is not the only thing to be kept in mind. A broad and statesmanlike view will take into account the effect of such an arrangement as this European system of state

banks upon the general business of the people constituting the several nations.

It may be considered good finance to force a bank of this kind to perform services for the state without remuneration. But when the root of the matter is reached the fact is that the exaction of the unremunerated service constitutes a tax laid upon the borrowers of the bank throughout the whole land. And when the bank is compensated through giving it a special privilege, such as a monopoly of note issue, I consider that the harmful effect is more important. A monopoly of that kind cannot but have a restrictive influence upon the usefulness of the banking institutions which are outside the monopoly. I have already indicated how such a monopoly conferred upon a central bank in the United States would tend to deprive small places of banking facilities which they would otherwise have. It may be that in each of those European countries the central bank is an absolute necessity for Government finance; but it is doubtful whether the United States Government is in the same need of its services. But it is time to consider the third method of governmental handling of its banking business.

The Canadian Treasury's System

The third method is that whereunder the Government has to deal with a number of large branch banks, each with a system of offices admirably situated for collecting the national revenues and carrying on the banking business of the treasury. In this case the banks are paid for their services according to the value of the work done by them. There is no monopoly, of note issue or anything else, given to a favored institution; the banks are treated as equals; when the revenue is in process of collection it does not happen that a large mass of funds is transferred from the commercial banks to a Government vault or to a central bank; the funds are simply transferred from one

commercial bank to another, and no matter where they lie they are available for use in discounting the paper of the general public. This is the system that has been worked out naturally in Canada, and I propose to sketch the outlines of such a system for the United States (assuming that branch banks will ultimately be adopted) that would obviate the necessity or desirability of a central bank and of the sub-treasury banking operations.

Revenue Collections Occasion No Disturbance

Perhaps it will be objected that the Canadian Government's financial transactions are of trifling consequence when compared with the national finances of the United States, England, France, or Germany; and that a description of the smooth working of the Canadian system would not constitute proof or evidence that the same system would work satisfactorily when applied to such a large aggregate of transactions as pass through the United States Treasury. There may appear to be force in this objection when it is remembered that the gross revenue of the Dominion Treasury in the fiscal year ending March 31, 1910, was but $100,000,000, which is a very small sum compared with the annual revenue of any one of the other three countries mentioned. However, there is no reason to suppose that in the future the Canadian system will work less smoothly and easily than it at present works. I have no hesitation in expressing the opinion that when the Dominion's revenue is five or ten times as large as the $100,000,000 of the fiscal year just closed the collection and disbursement of the Government funds will proceed nicely and easily. To-day there is no part of the financial machinery subject to noticeable pressure or friction. There is no class of borrowers in Canada who concern themselves in the slightest degree about the matter of the Government's balances in the banks. In fact,

neither the collection nor the disbursement of the revenues is ever mentioned in the press as a factor bearing on the monetary situation in Canada. A system which does its work as applied to a revenue of $100,000,000 in such a manner that the business interests take no notice at all of its workings is surely efficient; and I leave it to my readers to decide, after I have explained a few of the details, whether or not it is susceptible of being applied with good results to the much larger transactions and totals of the United States.

The Government's Fiscal Agents

I have just remarked that in their dealings with the Government the banks are on an equal footing. That statement requires to be modified. For in London the Bank of Montreal is the fiscal agent of the Dominion of Canada. The bank handles the various issues of Government bonds, pays the interest on the public debt held abroad, and generally gives its services as fiscal agent. As compensation for this work the Government pays a cash commission—whatever it and the bank agree upon as being reasonable. The Government does not hamper and hinder the operations of the other banks by giving the Bank of Montreal special privileges or by giving it monopolies.

That is the arrangement in London. In Canada also the Bank of Montreal is the chief fiscal agent of the Government. The revenues find their way to the credit of the Government accounts in that bank, and the expenditures are made by means of checks drawn by the different Government departments upon the bank. But all the important banks assist in the collection of the revenue; all assist in its disbursement; and all are given a share of the Government's deposits as recompense for their services.

The balances carried by the Government are, however,

not large. In the bank statement for February 28, 1910, for example, the total is $8,524,657, and this is divided among twenty-two banks. The balances, apart from those carried in the Bank of Montreal, range from $9,986 to $348,012. The Bank of Montreal, which does the major part of the work, has $7,040,608 of Government funds. Rarely does the total of the Dominion Government's deposits in Canada amount to so much as $15,000,000.

The Disbursements

The expenditures are made by check on the Bank of Montreal, Ottawa. All chartered bank branches are required by law to pay checks of the Dominion Government at par. So the collection of the revenue merely means the transfer, in the books of the commercial banks, of funds from the accounts of individuals and companies to that of the Government; and the disbursement of the Government moneys means the transfer of the funds back again from the Government to the individuals and companies.

There is, however, one class of Government disbursement which removes the funds from the reach of the private borrower. It is composed of the payments remitted abroad for interest on the Canadian debt held in Europe, and for other obligations.

The Canadian Government does not exact specific security for moneys deposited by it in banks, but it is protected by the clause in the Bank Act which stipulates that the amounts due by a failed bank to the Ottawa treasury shall rank immediately after its note issues and ahead of all other obligations.

The Banks as Fiscal Agents

I am convinced that if branch banks had developed in the United States in the same manner as in Canada the

relations of the treasury with the banking institutions would have shaped themselves very much the same on both sides of the boundary line. Then the banks would have had the credit and the machinery for undertaking the banking business of the treasury and, if no central bank existed, they would gradually have assumed the treasury's functions, because they could perform them so much more satisfactorily. It would be an easy matter to arrange a plan under which the whole of the revenues would be paid directly into the banks by the collectors and by parties paying the taxes. And all Government disbursements might be made by means of checks on the various depositories. The several depository banks would instruct their branch offices to accept and give receipts for all moneys deposited for Government account, whether pertaining to customs, excise, post-office, or other revenue. In return for their services in receiving the revenue, transmitting the funds to points desired by the treasury, and paying treasury checks at all branches, the banks would be entitled to have Government balances up to a reasonable amount free of interest.

Bond Security for Treasury Balances

Under the present system the depositories are required to lodge Government bonds as security for treasury balances held by them. When the treasury deposits $100,000 in a national bank, the bank must deliver the same amount in Government bonds as security for the deposit. Thus there is necessitated the purchase of bonds at least equal in value to the amount of the deposit; and actually the bank gains no new funds whatever, but it makes a profit because it pays no interest, or perhaps 1 per cent., on the treasury balance which it holds, while the bonds yield 2 per cent. or more. This statement holds notwithstanding the fact that it sometimes happens that a bank, on receiving a new Government deposit, al-

ready has on hand sufficient bonds of the type required as security therefor. In all probability the bonds will have been purchased beforehand with this end in view. Or, if they were purchased for another purpose altogether, it may be that, on their being diverted for use as pledges against Government deposits, other bonds are to be purchased to replace them. Of course, it might happen that a bank purchased a certain amount of Government bonds solely for investment, without reference to the possibility of its taking out note circulation or being allotted treasury moneys on deposit. But it is hardly likely, if there was no thought of the note circulation or of treasury balances, that bonds bearing so low an interest rate as United States Government bonds would be selected for investment, except by some ultraconservative institutions.

The United States Treasury and Branch Banks

If, on the other hand, it were possible or practicable for the treasury to deposit its revenues and carry its balances in the banks without requiring them to lodge specific security of any kind, then it would probably come about that the collection and disbursement of the national revenue would proceed without occasioning much, if any, notice from the borrowing classes or the general public. If the Government were given a preference over other depositors it would be in much the same position, as regards security, as at present; and the position of the ordinary depositors would not be sensibly altered for the worse, since the exaction of the bond security is a preference in effect.

Here again the branch banks would prove decidedly beneficial. Suppose there were banks of that character, and the treasury had an arrangement with several of the more important banks in each section of the country to receive all revenues and disburse all payments, no bond or specific security other than the preferential standing

being required, the mercantile and market interests would hardly be aware of the treasury operations at all. Both the collection of the revenue and the disbursements of the treasury would consist nearly altogether of transfers on the books of the banks.

It would happen frequently, when an importer negotiated with his bank for a loan to pay customs duties on a consignment from abroad, that the proceeds of the loan would be placed to the credit of the Government's account, and that no cash payment was necessary. And when the Government made a heavy payment to a ship-building concern, or to another creditor, the transaction might represent merely a transfer from the Government's balance to that of the ship-builder's. This transfer might be made in the books of one principal branch, or it might be from one branch to another branch of the same bank.

Collection and Disbursement of the Revenue

These would be special cases. In most instances revenue collections would consist of transfers from the accounts of customers of one bank to the credit of the Government in another; and treasury disbursements would consist largely of transfers from the Government account in one bank to the accounts of customers of other banks. No matter where the funds lay they would, until they were sent out of the country, be in the keeping of commercial banks and available for commercial borrowers.

Suppose the Government's balances rose to $220,000,000, as they did during the 1907 panic, and suppose they were divided among fifty great institutions. That would give an average of $4,400,000 per bank; and probably in most cases the Government deposits would represent less than 5 per cent. of the bank's total deposits. If a bank with $100,000,000 of deposits holds Government deposits of $4,000,000 or $5,000,000 a preference or priority given

to the treasury balances would not weaken the security of the ordinary deposits to an appreciable extent.

At present the payment of large sums into the treasury often means the taking away of credits enjoyed by mercantile, manufacturing, and producing interests. If there were branch banks and the practice changed, as I have explained, the necessity for that would pass; the Government's operations would be passed through an immense clearing-house comprising the whole country. There would be a large number of transactions wherein scarcely any cash need change hands, owing to entries offsetting each other.

In regard to the ability of the branch banks to relinquish the Government balances when required, there need be little apprehension. Each bank would quickly arrive at a perfect understanding of the working of the Government account carried by it. It would know in what manner the funds might be used so as to yield some profit and yet be available when called for.

The Comptroller of the Currency

At this point I may with propriety refer again to the change which the institution of branch banks would effect in the relations of the banks with the Comptroller of the Currency. The Comptroller now has seven thousand national banks to supervise. He must obtain statements from them; he must use his best endeavors to discover whether they observe the laws; and he must take the responsibility of closing weak banks or of letting them continue in operation. Also he is conscious that the banks under his supervision comprise less than one-third of the banking institutions of the country; in other words, the bulk of the banking business of the United States lies outside his influence or jurisdiction.

The collection, tabulation, and arrangement of the details submitted by seven thousand separate units involve

a huge amount of labor; and the task grows ever more formidable with the steady growth of the number of national banks. Then, it always happens that there are a considerable number of delinquents. Some banks offend against a certain rule; others offend against a different rule; and others again go contrary to something else that the law stipulates. It would hardly be practicable to invoke the legal penalties against all violators of sound laws or sound practices. They are too numerous. It would be different if the Comptroller might concentrate his attention upon a few offenders. In this respect the inauguration of branch banks would greatly simplify the relations of the Comptroller with the banks. Instead of being able to give but a microscopic share of his attention to the affairs of each banking institution, he could, if he had only one-thirtieth of the present number to deal with, devote a fair share of attention to each one. In all probability the delinquents would be few in number; and that being so, it would be possible to deal with them in a more satisfactory manner.

Reduction in the Number of Banks

Suppose there were in process a steady transformation of single-office banks into branch banks. Each statement day would see a decrease in the number of banks reporting to Washington; but the statements received would cover an increasing proportion of the banking business of the whole country. It might be twenty-five or thirty years before the process was in anywise complete. While it was under way American banking and finance would be growing more stable and satisfactory. When the transformation was completed the responsibility for collecting statistics from the thousands of branch offices, and for transmitting the consolidated returns to the Comptroller, would rest with the banking executives in the centres of the different geographical sections. These

executives would have much better means than the Comptroller possesses of disciplining delinquent officers. They could easily arrange matters so that returns from all offices were forthcoming with reasonable promptness and certainty. So far as observance of the laws is concerned, the rules and regulations of each bank, governing all its branches, would necessarily be based on the law of the land.

The returns published by the Comptroller would derive a new significance.

The Banking Position by Geographical Divisions

For the general public the five abstracts published each year contain only totals and generalizations; they give no opportunity of studying the progress and position of the individual banks. The statements, however, show in a measure the banking development of the different cities, states, and sections. But they are imperfect, even for this purpose, since they contain nothing but the national bank figures.

If the country were served by branch banks, with the offices of each large institution extending into several sections or divisions, it perhaps would not be feasible to show the development of the banking figures of the respective geographical divisions or of the cities and towns. The Government could, of course, require each bank to publish the balance sheet of each branch; and in that way the loans and deposits in the several districts could be arrived at. But such a requirement would be calculated to annoy and distress the banks. It would mean that each institution would be compelled to provide, for the benefit of its competitors, a list of the places where it had good and profitable business. It is very likely that the publication by any bank of the fact that it had a large line of deposits, or discounts, or both, at a certain point, would result in inducing several new competitors

to appear at that point; and they would, of course, take active measures to undermine its position. The risk of attracting formidable opposition through publication by a bank of the details of its business at particular points would be much greater than the risk incurred at present by a single-office bank in publishing its figures.

It is a much more difficult and laborious matter to organize a new bank than it is to merely establish a new branch of an existing bank. The process whereby a large bank establishes an office in a territory or district where another bank has an extensive and profitable business is simple and easy. An order from the general manager covering the renting of premises, the sending of stationery and other supplies, and the appointment of the staff is all that is required. If the branch proved unprofitable it would be withdrawn, and the stockholders of the parent institution would not notice the loss. But if the newly created single-office bank should fail to meet the expectations of its founders it might be necessary to close it, or liquidate it, or sell it to another concern—in any case the stockholders would experience a disagreeable loss.

XVII

BRANCH BANKS AND BUSINESS MORALITY

A Comparison of Commercial Paper

IN his address to the Missouri Bankers' Association, from which I have already quoted, Dr. Joseph French Johnson made the following admission (see the *Financier*, New York, May 17, 1909): "Now the quality of bankers' credit in Canada, I am sorry to say, is a little better than it is in the United States. I don't know about Missouri, but in those parts of the United States with which I am familiar I think the quality of our discounts, on account of the system of granting discounts, is poorer than in Canada. In Canada the business man deals with one bank. He gets a line of credit at the beginning of the year. He is told that he may have \$20,000, \$30,000, \$40,000, \$100,000, or whatever his needs happen to be, depending, of course, upon the bank's opinion of his credit. He knows what he can rely upon, but he must not sell paper in the street, he must not borrow from anybody else, but lean absolutely on his bank, and they take care of him.

"Then the law gives each bank grants which make it remarkably easy for the bank to protect itself. Section 88 of the Bank Act has all the effect of a bill of sale. The bank practically owns the wholesaler's stock or the manufacturer's stock if it so chooses. Whereas in the United States we have smaller banks; a great many business men borrow from different banks, sell their paper on the street, so that no one banker is ever sure of the quality of the assets in his portfolio."

Before proceeding to carry out the main purpose of this chapter it will be well to deal with the remark in the second paragraph referring to the extensive powers of sale and ownership possessed by the banks over the goods of certain of their debtors. It is indeed true that the Parliament of Canada has granted large powers of this kind to the banking institutions, powers which have a considerable effect in protecting them from losses from bad debts.

For the Benefit of Industry and Trade

Doubtless it will seem to some readers as if legislation of this kind had been enacted solely in the interest of the banks. They probably will believe that the banks initiated it in order to save themselves from making losses. That idea would not be correct. The Parliament of Canada would hardly have consented to confer large powers of this kind upon the banks merely to enable them to earn better net profits. One of the main ends held in view by the parliamentary managers who were responsible for these clauses was to create a set of conditions under which the banks would be impelled to place their resources freely at the disposal of agriculture, commerce, and industry. They considered that the best way to do so was to provide laws which would enable the banks, with safety and comfort, to employ their resources in loans and advances to producers, merchants, and manufacturers. The powers were granted quite as much in the interest of trade and commerce as in the interest of banking. It might be said that the whole policy of the Dominion in regard to banking has latterly been framed on broad statesmanlike lines. Parliament has abstained from binding or fettering the banks unduly, and from diverting or directing their investments into particular securities or loans.

Influence of Banking Systems Upon Commercial Morality

But it is time to discuss the matter of the influence exerted by different systems of banking upon the commercial morality of the people served by them. Doctor Johnson says he thinks the discounted paper in Canada is a little better in quality than the paper in the United States, partly because of the system of granting discounts and partly because of the extensive powers possessed by the banks over the goods of their debtors.

Clearly there is involved here the question as to whether commercial morality in Canada is higher or lower than in the United States. Are the debtors of the banks north of the international boundary more honorable, more punctilious about meeting their engagements than are bank debtors south of it?

To this question I do not propose to give a definite answer. It will be sufficient to show in what manner certain characteristics of the banking systems in vogue respectively in the United States and Canada influence the business morals of the people.

Effect of a Bad Example

In recounting the things which bear upon the business morality of banking debtors in the United States I would assign a prominent place to the frequency with which the banking institutions have generally suspended cash payments. There is a striking contrast in this respect between the records of the two countries. It is now over seventy years since there has been a general suspension of specie payments by the Canadian banks. The United States record is five times in fifty years. The thing has occurred twice in the past eighteen years. I have shown that these numerous suspensions cannot have been due to any other cause than the single-office banking system.

In these suspensions, as in such suspensions wherever they occur, the banks refused, or were unable, to pay their just debts in the form prescribed by law and by custom or usage. After regularly taking deposits of cash or its equivalent from their customers under a positive contract to repay them in that form on demand, they, on several successive occasions, repudiated that contract. On the last two occasions they offered to their creditors depreciated certified checks or clearing-house certificates instead of the cash to which the creditors were entitled.

Now it must be that even a single instance of general suspension of banking payments will exert a profound effect upon the morals of the debtor classes of the country in which it occurs. The effect must be vastly increased when the instances of suspension are multiplied. It can have none other than a debasing influence upon the character of the people. If the banks, to which everybody looks for examples of probity and faithfulness, repudiate whenever they find themselves in difficulties, why should ordinary debtors be expected to do otherwise? When circumstances make it difficult for him to meet his note at the bank, the debtor, you may be sure, has his creditor's numerous lapses in mind; and if he is not strongly endowed with good principles he is impelled toward devious ways. Instead of holding his mind firmly to the necessity of meeting his bond in the agreed-upon manner he casts about for means of evading his responsibility.

On the other hand, an unbroken and honorable record for due payment of its obligations materially strengthens the position of a bank in relation to its borrowing customers. Its debtors when pressed can never throw in its teeth the reproach, "You suspended payments to your depositors and the law did nothing to you."

Thus this circumstance imparts a certain superiority to the discounted paper. The bank has a moral advantage in enforcing collections over another bank which has suspended several times in the memory of its customers.

Blacklisting the Cheats and Scoundrels

In the chapter on defalcations and frauds I explained how branch banking would have a tendency to lessen them through subjecting all the banking offices in every part of the land to uniform systems of rules and regulations and to a continuous supervision and examination more effective and thorough than the present system. It will, perhaps, be admitted that the instances of banking fraud and defalcation, which are constantly coming to light, besides have a tendency to lower the credit of the banks in the eyes of the depositors, tend to weaken the moral fibre of debtors generally. Suspension of cash payments is one form in which the bankers have set a bad example to the rest of the community. Another form of bad example is seen in the frequency with which defalcations occur.

Next to be considered is the work done by the banks in the two countries in educating their customers. Under the branch system a powerful machine works with uniform pressure upon the borrowing community in every part of the land. A faithless borrower does not escape his creditor bank by moving to another place, for the chances are there will be another branch in his new locality, and he will not be suffered to rest in peace. Direct pressure extends everywhere, and he is made to feel that the arm of the bank reaches into all corners of the land, and that honesty is the best policy. Of course, a cheat or a scoundrel is blacklisted at all branches of the bank which he has defrauded. The bank not only refuses to deal with him directly, but it warns its customers against him also when it perceives evidences of his dealing with them. It may happen that one bad transaction will forever close the doors of every chartered bank in the country against the offender. When they have been defrauded large branch banks press the perpetrator of the fraud with the whole machinery of the law as a matter

of policy. They do this more regularly and more rigorously than small local banks. Although the American Bankers' Association follows the practice of regularly pursuing and prosecuting burglars, forgers, and swindlers, it does not take such an active part in punishing fraudulent borrowers.

The Asset of a Good Character

All this has its effect on business morality. But perhaps the factor bearing most strongly upon this issue is the machinery by which the discounting business is carried on. Take a small trader or storekeeper in Canada who borrows $3,000 or $4,000 on his customers' trade-bills and on endorsed accommodation notes. If he is careful of his credit at the bank, and at the same time successful with his business, his account will furnish a continuous record of a favorable nature. It is not alone upon the officers of the local branch that the good impression is made. The executive officers are also impressed, and the impression thus made constitutes for him a valuable asset. It ensures him the consistent support of one of the strong financial organizations of the country, and will stand him in good stead wherever he goes in the Dominion.

If, on the contrary, he indulges in sharp practice, and by means of that inflicts a loss of $500 or $1,000 upon the local branch, the fact will be inscribed upon the records at the branch and at the head office. Even if the branch manager, because of his shame and humiliation at being outwitted, feels disposed to pocket the loss and say nothing about it, the head office will probably insist upon a rigorous prosecution if the delinquent debtor has broken the law. It does so with the purpose of impressing upon the people of the community the fact that the bank cannot be defrauded with impunity at any of its branches. Every such prosecution, every instance in which the per-

petrator of a fraud is tracked down and punished, tends to improve the business morality and to improve the quality of the paper in the bill cases of the banks.

The Borrower and His Bank

Every liability account of any consequence carried by the Canadian branch bank is watched by the head office experts as well as by the branch manager. Though the branch managers are trained men, possessing a wider knowledge of banking risks than the men in charge of many of the smaller banks in the United States, they are inferior to the general managers at the head offices in the matter of judging credits. At the branches attention is given largely to methods of increasing the volume of business and the profits, while at the head offices a great deal more consideration is given to the prevention of losses and the financing of borrowers' accounts in such manner as to make them safe for the bank and a means of ensuring solid and lasting prosperity for the borrowers.

Responsibility Undertaken by Branch Banks

I explained how the banks conduct a careful examination of the affairs of each business man or firm applying to them for credits. The customer must submit full and satisfactory statements of his position and affairs. The bank will seek to verify the particulars furnished by the applicant through inquiring about his record at the commercial agencies if it cannot satisfy itself by studying his record at the bank. In considering applications much importance is placed upon character. It is almost an essential that a man applying for a credit shall have a good character. There may be cases where a bank can lend money to a rogue or a scoundrel without danger of loss. It may, in case of each loan, demand specific security that will protect it without reference to the bor-

rower. But as a rule these men are avoided if possible. There is a strong disposition to extend credits and facilities to parties bearing good reputations and possessed of qualities likely to enable them to succeed in business even when they have very small capital.

When the credit is granted it will be for a certain sum, believed to be sufficient for the borrower's requirements; and provided he continues worthy of his credit, the bank undertakes a measure of responsibility for seeing its customer through the season or year.

How the Bank Watches Its Borrower

Undertaking such responsibility the bank assumes the right to keep the closest watch upon the customer's doings. It will observe his habits to learn whether he attends properly to his business and whether he maintains sobriety. He is given to understand that he must not borrow elsewhere, and that the bank prefers to have all his receipts deposited in his account, and his payments or disbursements made by check. If this is done the local branch manager has a comprehensive view of the customer's business. He knows the volume of sales, where the payments are made, and what they are made for.

The credit authorized by head office will be accompanied by exact instructions as to the security to be given.

Dishonesty Endangers the Credit

If there are signs that one of these customers is not honest, or if the record of his dealings contains indications of dubious conduct, the bank's inspector may advise the general manager to order the account closed. The branch manager may, likely enough, resist the order; and if he can satisfy the general manager, in his correspondence or by means of a visit to head office, that the bank can with safety continue the loan, it may be carried. The point is

that on the first appearance of dishonesty or bad moral conduct on the part of the borrower the head office will begin to press for the liquidation of the loan, while the local banker may be desirous of continuing it. It is obvious how in this way the branch system tends to promote honesty and morality in a more effective manner than the local system. It often happens that the local officers are averse to taking harsh measures against parties in their own town, even when it is clear that they should be proceeded against or punished. Disinclination to cut down the volume of their business, and dislike of taking action that might stir up local sentiment, operate to induce them to hold their hand. But the expert bankers at the head offices in the large cities are not deterred by those considerations.

Business Men Under Expert Observation

It is the doubtful accounts and the accounts which may become doubtful that occasion the bulk of the correspondence between the head office and the branches. Letter after letter is dispatched to the branch, asking explanations, taking exceptions to particular features of an account, and ordering changes in methods or securities. In short, every precaution that suggests itself to a skilled professional mind is taken to prevent these customers from inflicting loss upon the bank.

Now these are the people among whom the immoral business men are chiefly found. And thus it is the case that under a good system of branch banks the whole class of them, in every part of the country, is brought under the special observation of the best banking talent and is subjected at nearly every village, town, and city to the strictest rules and the most expert control. In dealing with defalcations and frauds by bankers it was explained that while bankers in the United States and in Canada might be by nature equal in point of morality, the exist-

ence of the branch system in the latter country makes it much harder, as a rule, for a Canadian banker intent upon fraud to accomplish his purpose. In the same way the efficiency of the branch bank machinery, which places the borrowings of all classes of the people under the control of experts and ensures that each borrower shall borrow only at his home bank, makes it more difficult for an immoral business man to defraud his bankers, and thus tends to raise the tone of business morality.

Laxity in the Civil Laws

I concede here that the nature of the civil laws governing bank loans and investments has an important effect upon the morality of business men. In any country when debtors become involved in difficult circumstances many of them will repudiate their obligations if the laws permit them to do so. Any looseness in the laws which makes it difficult for banks or other creditors to enforce collection of their rightful claims, and prevents them from obtaining satisfactory title or right to securities or goods forming the basis of their loans, tends unmistakably toward a low standard of business morality. Laxity of this kind in the statutes also tends to make it more difficult for worthy borrowers to secure the credits they need, and tends to make interest rates generally higher. On the other hand, wise legislation of the opposite character enables banks and other lenders to supply credits liberally to men of good character and ability, engaged in almost any kind of legitimate business; it also helps to keep interest rates down.

XVIII

CONCLUSION

A Comparison of Interest Rates

IN this, the concluding chapter, before proceeding to summarize the various points of my argument, I shall devote a few pages to the matter of the interest rates paid by bank borrowers in the United States and Canada. Taking the two countries, and considering how vastly the former exceeds the latter in wealth and development, one would expect that the rates of interest for commercial borrowers would be much lower south of the international boundary. Actually there is not a great deal of difference, and in many respects the conditions in Canada are better for the borrowers.

In the United States there is a market for commercial paper at New York, Chicago, Boston, and perhaps a couple of other cities, in which paper can sometimes be sold on the basis of very low rates of discount. The rates quoted bear a more or less close relation to the rates prevailing for time money in Wall Street. When money is cheap in Wall Street the rates of interest on commercial paper in these city markets are less than those paid by the best borrowers in Canada. But it is only the largest and best-known concerns which can borrow at those rates in the United States. And at times—the fall of 1909 and that of 1910 are two recent examples—they must pay 6 per cent. and more, while the best mercantile borrowers in Canada are paying 5½. I understand that the important borrowers in Buffalo and other cities of its class,

and in the smaller cities, are accustomed to go to New York or Chicago for their accommodation. They could not borrow from the banks in their home cities for less than 6 per cent. or thereabouts.

Loans Based Upon the Borrower's Deposit

Also, it is well known that in New York and in all cities the banks very generally limit the credit which they will give a customer to an amount five times as large as his free balance on deposit. Putting it in another way, they insist that the borrower shall leave one-fifth of his loan or advance on deposit with the bank free of interest.

This, of course, amounts to charging a higher rate of interest than that named in the agreement. A customer who required \$8,000 would be obliged to give his note for \$10,000 and leave \$2,000 at his credit in the bank. If the rate of discount was 6 per cent. the actual cost would be \$600 per year for the use of \$8,000, or 7½ per cent. This fact should always be borne in mind whenever a comparison of interest rates in the United States and Canada is instituted. The Canadian banks are not able to enforce any such terms upon their borrowers. The bankers would be glad indeed if they could do so. But the competition is so keen in every part of the country that many borrowers get advances in the form of overdrafts, and when that is the case the borrower only pays for the sum he actually uses. Thus it happens that a nominal rate of 6 per cent. charged by a bank in an American city quite often means 7 or 7½ because of this stipulation regarding the free balance; while a rate of 6 per cent. in Canada means in most cases 6 and no more. It is a fact that in almost every town and city in Canada, and in some very small villages in the East and in the West, the few A1 borrowers get their accommodation at 6, if not 5½.

A Higher Deposit Rate and a Lower Discount Rate

And it should be remembered, further, that at every banking office in the Dominion the banks stand ready to accept savings and other time deposits from every one at 3 per cent. In the United States there are plenty of commercial banks which do not allow interest; and a great many which do not allow more than 2 per cent. I consider it likely that in the United States, especially in the East, the commercial banks pay a less average rate on their deposits than do the banks in Canada; and taking them throughout the whole country, outside the principal reserve centres, they charge their regular borrowing customers a higher average actual rate for an accommodation which is not so valuable as that extended by the Canadian branch institutions. And where the commercial banks pay a higher rate for their deposits than the Canadian 3 per cent.—in some Western and Southwestern states for example — the discount rates actually charged are much higher than Canadian borrowers in similar circumstances pay.

A moment's thought discovers that this is but a natural consequence of the difference between the banking systems. It is one of the places where the more economical working of the branch system shows itself. Their relatively cheaper cost of operation and their relatively higher state of efficiency permit the branch banks to pay more for deposits, to secure the depositor better, and at the same time to charge less on discounts, and for the lower rates to give an accommodation that is worth more to the borrower.

Branch Banks the Rational Solution

There is a disposition on the part of some opponents of the branch banks to regard them as being perhaps well suited to the needs of a poor and thinly populated country

but not at all adapted for operation in a rich, populous country like the United States. This is not an argument that a banking expert would use, for he would understand clearly enough that the experience of the European nations furnishes convincing evidence of the suitability of the branch bank machinery for handling large totals and transacting the banking business of large populations.

For the benefit of readers who are not familiar with the admirable manner in which the great branch banks of Europe perform their functions, I shall now give some general reasons why it appears that branch banks would constitute a rational solution of the banking problems.

I have already tried to show, I hope successfully, that there is much misconception regarding the branch institutions in the minds of the bankers and of the public; that the fears, commonly entertained, that branch banks would extend and perpetuate the Wall Street domination over the rest of the country are not founded upon reason; and that it may be expected that branch banks would extend quite as effective a support to local industries as the independent local banks now supply. It is an easier task to show, by means of a broad and general survey, that branch banks would constitute the rational system for the United States, and that they would harmonize nicely with the business conditions prevailing in the Republic.

Transactions with the Politicians

I explained how convenient they would be for the transaction of the Federal Government's financial business. In the same way the state government accounts should logically be carried by powerful institutions commanding the respect of the whole country, able and willing to make large advances when necessary, and strong enough to carry the deposit funds of the states without pledging

specific security therefor. For carrying the accounts of municipalities also the branch banks would be very suitable. Some of the most disagreeable and humiliating scandals in American banking history have had their origin in the dealings of state and municipal politicians with the local banks. These politicians, with their power to dispose of large sums of state or city deposits, sometimes acquire a strong hold over certain of the local banks. They will, perhaps, after they have been canvassed by the officers of a bank in their constituency, give it a large deposit, perhaps more than it is entitled to. The bank may compensate them through lending them money on inadequate security or through paying straight bribes of cash, as in the case of the city of Pittsburg. In either case the result is demoralizing and dangerous for the bank, and unprofitable for the state or municipality concerned. I venture to assert that small banks with purely local boards are apt to be more susceptible to political pressure of this kind than large branch banks would be. A great institution with branches in every part of the Union, and priding itself upon its good name, would not likely be willing to dishonor itself for the balances or deposits of any particular state or city. Neither would its officers be disposed to risk their stockholders' moneys in loans to shady politicians for whom they entertained nothing but contempt. Even a branch bank, the operations of which were confined to a particular state, might be expected to withstand political pressure better than a single-office local bank, especially if its stockholding were scattered through the state. It would be ridiculous to say that all local banks are susceptible to influence of this kind. Most of them would treat these immoral propositions with the scorn they deserve. But in my opinion it is fair to say that in every state there will always be some local banks willing to buy politicians, or to be bought by them. Under the branch system the chances of that would be lessened.

CONCLUSION

The Movement Toward Concentration

Next, consider the great railroad and industrial corporations. In no other country are they so large as in the United States. Many of them have branch establishments in every section of the country, and some have establishments in a number of foreign lands. Surely it will be admitted that large branch banks would constitute the natural and proper means for transacting their business. The wealthy railroad and industrial interests could scarcely dominate or influence unduly the policy and operations of banks such as I have described in the preceding chapters. It has been remarked that in the railroad and industrial world the tendency in recent years has been steadily toward concentration of capital and control. Notwithstanding that Congress and many of the state legislatures have sought to prevent it by stringent laws, the concentration has gone forward almost irresistibly. One reason it has done so is that capital can work to better advantage when concentrated. If banking were allowed to develop naturally it would be toward concentration. As a matter of fact, the prohibition or discouragement of branches does not prevent concentration of banking capital. It merely ensures that when concentration takes place it shall be attended by results disagreeable and inconvenient for the general public.

The Branch System Accepted in Commerce and Industry

I have mentioned the fact that many of the great industrial concerns have branches in every part of the United States. Also the great mercantile or trading corporations are establishing branches in all directions. The agencies of the great life and fire insurance companies are in effect branches of the parent organizations. So in industrial and mercantile life, and in some divisions of

financial life, the branch principle is accepted. People are not disposed to argue that a branch factory, or a branch store, or an insurance agency, is detrimental to the public interest. I do not know of any business—industrial, mercantile, or financial—in which branches are so advantageous or so useful as they are in banking. In banking the necessity for employing the services of branches in other localities is constantly arising; and the usefulness of the various units to each other, to the parent organization, and to the localities they serve is constantly in demonstration. To forbid them appears to me somewhat like placing artificial barriers or hindrances in the way of the circulation of the blood of the financial organism.

The Rights of the Borrowing Classes

In the course of the argument I have tried to show that the two items which figure so prominently in the discussion of banking reforms—the currency question and the matter of panics—constitute only a part of the problem. Any remedy which proposes merely to provide a suitable currency and to provide machinery to enable the banks to go through a panic without dishonoring themselves and the country is insufficient.

In every country it will be found that the borrowing classes are always in the forefront in the matter of building and developing the national wealth and resources. It is the borrowers who courageously risk their own funds and undertake heavy responsibilities in order to better their circumstances; and whenever they succeed in doing so they have at the same time succeeded in building up their country's resources. It is the army of borrowers who have conducted and operated the industrial and mercantile businesses that have built up the immense resources of the United States. My contention is that in any discussion of the banking question the claims of the

borrowing classes should get due consideration. The present banking system falls far short of giving them what they have a right to expect; but, as they are not familiar with the benefits enjoyed by borrowers in other countries, they do not figure prominently in the present controversy.

Recapitulation of Points

I think I have said enough to indicate that there are very important interests in the United States which would benefit materially from the institution of a system of good branch banks with powers of issue and devoting themselves to commercial banking. I may now recapitulate the points which I have endeavored to bring out in the course of the argument. Putting it briefly, if the single-office banks of the United States were transformed into branch banks one might expect that there would ensue:

1. An improvement in the record of defalcations and frauds. Effective methods of checking and preventing frauds would be put in force in all banking offices, and would be supported by an up-to-date system of internal inspection.

2. A large reduction in the number of bank failures and in the average annual loss suffered by depositors. The transfer of the banking business from thousands of small bankers to a few strong, well-managed concerns, subject to internal and external examination, would increase the financial stability.

3. A reduction in the expense of conducting the banking business combined with an increase of efficiency. Both borrowers and depositors would benefit from this, as would also thousands of persons who now have no transactions with the banks.

4. An improvement in the record of panics. They would not likely be so destructive, and suspensions of payments would be very unlikely to occur. Cohesion and

co-operation of the banking units would tend toward this result.

5. An improvement in the conditions of the banking service. Every bank clerk who possessed ability and good moral character would have the chance to rise rapidly to high-salaried and dignified posts. And the efficiency of the officers and men would be increased.

6. A notable extension of good banking facilities to small villages and country communities. Owing to the small expense at which branches can be operated a branch bank would find a profit in a small annual turnover.

7. An extension of facilities to the residential, retail, and factory districts of the cities, and into the suburbs as well. The branch banks would be found in all city districts, and would undertake business of all kinds for the citizens.

8. A marked improvement in the facilities extended to large manufacturing and mercantile borrowers. These would be able to borrow altogether from one bank, or a couple of banks, which had branches in their immediate proximity.

9. A smooth and comfortable handling of the harvest movement. The transfer of currency from the centres to the country districts could be accomplished without the forcible transfer of credits which now accompanies the transaction.

10. A satisfactory and permanent solution of the currency question. The branch banks could be made to provide an elastic and thoroughly safe currency. Their note issues would constitute an exact measure of the currency requirements of the country in all seasons.

11. A large economy in the use of cash. With the extension of the bank branches into small places would come the utilization by the banks of a huge fund of cash now carried in houses or on the persons of citizens.

12. A lessening of the extent of Wall Street's domina-

tion over the other parts of the country. In each section a counterpoise to the Wall Street power would exist, and the banks of the several sections would handle their own New York business.

13. A larger measure of banking publicity. The bank statements would cover the whole banking business of the country, and the position of the individual units could be followed more satisfactorily and more closely by interested depositors and students.

14. An entirely satisfactory settlement of the problem regarding cash reserves. They might then be carried at the centres, where they should be, and yet remain in the hands of the banks owning them.

15. A passing of the necessity for naming a legal minimum of cash reserve. As other and better methods would be available for ensuring that the banks carried suitable reserves, this practice, which has the most mischievous effects, could be discontinued.

16. A more generous allotment of banking resources to commercial discounting. The diversion of resources into bonds would not be so extensive as at present.

17. A weakening of the opinion that commercial banks should not transact a savings bank business. With the institution of strong branch banks there would not exist the same necessity for separating these two departments of banking.

18. An effective competition on the part of the ordinary banks with any system of postal banks which the Government may institute. The credit of the branch banks would ultimately be nearly equal to that of the Government, and the facilities supplied by them would be superior.

19. A uniform rate of interest on deposits, and a reduction of the inequalities of the discount rates. Savings, in every small place, would command a fair rate of interest, and a scientific adjustment of the available cash resources of the various localities would occur. The surplus of the quiet Eastern village would be placed, in the

easiest and most satisfactory manner, at the disposal of localities where borrowers were more in evidence.

20. An improvement in the international standing of the United States. Branch banks would raise American prestige abroad, because of their large resources and high standing, and because of the improvements they effected in banking conditions in the United States.

21. A better and more effective support by United States banks to United States firms and corporations transacting business abroad. This department of the banking business would not be left so largely in the hands of foreigners.

22. An assumption by United States banks of the whole duty of financing the domestic business of the country. They would not be content to allow foreign institutions to take a large share of the work of financing the cotton, wheat, etc., to market.

23. An improvement in the business morals of the people. Debtors would be under firmer and more intelligent supervision, and banking credits would be more closely watched.

24. A simplification of the relations of the treasury with the banks. The Comptroller of the Currency would have two hundred or so banks to deal with instead of seven thousand; and the two hundred would cover practically the whole business of the country.

25. A transfer of the control of banking from the states to the Federal Government. This would make possible uniformity in the banking laws.

These preceding paragraphs suggest the principal points which I claim for the branch banks. In the course of my argument I have also indicated how the transition from the one kind of banks to the other might be effected without causing an undue amount of distress or loss to the owners of the existing banks. Also I have pointed out how in my opinion the interests of the general body of the stockholders, of the borrowers, depos-

itors, note-holders, and of the general public might be satisfactorily safeguarded from unscrupulous insiders or managers, and how it might be ensured that the branch banks on the whole would devote themselves honestly to the proper performance of their legitimate functions.

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